'Leaping the monetary abyss' from the (20 December 1971)

Caption: On 20 December 1971, German newspaper welcomes the agreements concluded at the Smithsonian Institute which, in particular, make provision for the realignment of the currencies of the industrialised countries and the adaptation of the system of currency fluctuation margins.

Source: Süddeutsche Zeitung. Münchner Neueste Nachrichten aus Politik, Kultur, Wirtschaft und Sport. Hrsg. DÜRRMEIER, Hans ; Herausgeber HEIGERT, H. 20.12.1971, n° 303; 27. Jg. München: Süddeutscher Verlag. "Sprung über den Währungsgraben", auteur:Thoma, Franz , p. 4.

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Leaping the monetary abyss

Franz Thoma, Washington

Half of the globe can breathe a sigh of relief. The monetary crisis that was being openly proclaimed on 15 August, when the gold convertibility of the dollar was suspended, has blown over — *for the time being*. The initial step, namely the fixing of new exchange-rate parities, on which the top ten industrialised countries agreed at their poker session in Washington, still has to be followed by a more thoroughgoing reform of the Western exchange-rate system that will kill off the worldwide bacillus of inflation. That remains an incomparably tougher task. Nevertheless, the past few days have shown that, when the chips are down and nerves are on edge, not even the player who lays the top trump on the table can ultimately escape the need to compromise.

That was what everyone was finally compelled to do in Washington — the Americans with their long-resisted devaluation of the dollar, the Japanese and Europeans with their revaluation and trade concessions, a situation in which Bonn, because of the excessively high rate at which the deutschmark has been floating, and Tokyo seemed to have been dealt the weakest hands, given the high rate of revaluation against the dollar. In relation to the other European currencies — those of our main trading partners — the picture certainly looks considerably rosier. Indeed, given the existing floating rates, the effect of the revaluation will be virtually tantamount to a devaluation of the mark against the other European currencies.

A painful memory

All compromises, however, pay dividends, whatever figures are weighed on the scales. The realignment that has now been set in motion will preserve the Western world from no less a fate than the guillotine of protectionism, which has already come crashing down once, at the end of 1929 and the start of 1930, when not only the New York Stock Exchange but also the international monetary system crashed, triggering a suicidal crisis and creating a vast army of unemployed workers, several million strong. Bitter memories! In the maelstrom of devaluation, currency dumping and the unavoidable foreign-exchange controls, world trade had dwindled by 1934 to less than one third of its 1929 volume — a rude awakening from the state of ‘perpetual prosperity’ that was thought to have been achieved back then. This memory was painful enough for the Group of Ten to conclude the exchange-rate agreement; let us hope that it will also be painful enough to compel the hundred-plus members of the International Monetary Fund to reform the monetary order very soon by ditching the dollar as the reserve currency and replacing it with a new standard, an artificial reserve currency, and, above all, by creating a more flexible system.

The fact is that the US dollar, once highly coveted throughout the world as the quintessence of the vitality and expansive power of capitalism, has now been dropped like a hot potato, to the extent that some 80 000 million dollars are now lying in the vaults of Western central banks. Devaluation alone will certainly not suffice to cure the present malaise of this reserve currency. The present devaluation of 7.89 % merely gives the United States a competitive advantage which most of its trading partners will find hard to digest but which will melt away like snow in the sun if the purchasing power of the dollar within the United States is further diminished. And that is exactly what seems to be happening. The reason why prices are currently rising more slowly in the United States is not that productivity is soaring or that costs are falling but that the Administration has been tinkering with the market mechanism, making investments that are anything but sound in order to lower production costs and actually creating an inflationary swell that is bound to burst the dam one day.

Enough floating already

Only if the Western world is able to replace the existing rigid currency structure with a more flexible system, including certain revaluation and devaluation mechanisms — in other words, with certain constraints designed to adapt parities to the purchasing power of currencies — will it be possible to avoid a repeat of the critical situation that has just been overcome. There are models for such a system, although it has to be said that the best and simplest model, namely freely floating exchange rates, is a non-starter. The

Federal Republic has let the mark float freely since May, but none of the other industrialised countries, apart from Canada, has even come close to accepting this model, although floating has undoubtedly protected Germany from new multimillion-dollar deluges, thereby preventing a further swelling of the money supply with its calamitous effects on the value of the mark, and has also made imports cheaper and compelled the German economy to pay strict attention to the cost factor, the wisdom of which has certainly been confirmed by the latest dollar transactions; in short, free floating has heralded a return to stability. Admittedly, such a unilateral measure, which was only implemented in self-defence against a dollar onslaught, cannot be sustained by a country that is more dependent on exports than all but a few nations on this earth.

This, however, does not mean that the demon of inflation is lying in wait again round the next corner; even when the exchange rate stops floating, industry will have to continue ruthlessly cutting its costs, rationalising and further increasing its productivity wherever the limits have not already been reached. And so, funnily enough, the unrelenting pressure created by what was ultimately a surprisingly high rate of revaluation against the dollar will ensure that our competitiveness in the world market, which was under threat, can be recovered by virtue of the prices for and quality of our products. The chances of success will be all the greater, the longer the lone champion of stability, Karl Schiller, is able to fend off the pressure from four sources — first, the trade unions, second, the employers, third, the reformist zealots and fourth, the apostles of growth. But the pressure is growing all the time, and the central banks are adding to it.

Stability and the monetary order

It is true that we are walking a dangerously narrow ridge above the economic abyss, which surely no one would deny. But is there not a sad inevitability about this, given that the early signs of inflation were allowed to develop unchecked from the autumn of 1968 to the autumn of 1970? Would it not be still more dangerous to relinquish the stability card now, even before it has been played? At least industrial producer prices, the precursors of consumer prices, are not continuing to rise. Should a degree of stability be restored, however, we must then arm ourselves all the more vigilantly against a repeat of the inflationary influx of foreign exchange, at least if the reform of the monetary system proves unsatisfactory. On the other hand, it can only ever be satisfactory if it compels all the major industrialised countries to practise strict monetary discipline. That, however, is uncomfortable, which makes it difficult to achieve.

Given the emergence of a certain degree of common sense — if we disregard the understandable haggling over revaluation and devaluation rates — is it possible to believe in a satisfactory solution? Perhaps. As Washington has shown, this world is still good for pleasant surprises, too. Who would have dared to hope, only six months ago, that the exchange-rate fluctuation margins would be widened so quickly, at least allowing the central banks to engage in a mini-floating operation? Crises are also the seedbeds of opportunity. The twenty cool calculators in Washington — ten Finance Ministers and ten Central Bank Governors — grasped their opportunity at the last minute. Will the hundred-plus members of the Monetary Fund, with their extremely diverse economic structures, also manage to generate a collective sigh of relief — this time across the whole globe?