'Not just cosmetic changes to the old system', from the Süddeutsche Zeitung (11 September 1971)

Caption: On 11 and 12 September 1971, the German daily newspaper Süddeutsche Zeitung asks the German economist, Hans Möller, a supporter of a monetary system based on a fixed exchange rate policy, for his views on the collapse of the Bretton Woods system.

Source: Süddeutsche Zeitung. Münchner Neueste Nachrichten aus Politik, Kultur, Wirtschaft und Sport. Hrsg. Dürrmeier, Hans ; Herausgeber Heigert, H. 11.-12.09.1971, Nr. 218; 27. Jg. München: Süddeutscher Verlag GmbH. "Nicht nur Retuschem am alten System", auteur:Möller, Hans , p. 23; 24.

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http://www.cvce.eu/obj/not_just_cosmetic_changes_to_the_old_system_from_the_suddeutsche_zeitung_11_september_1971-en-996ea1cd-15ac-4e61-8c54-8a74b642e2bb.html

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After the collapse of the Bretton Woods Agreement:

Not just cosmetic changes to the old system

Fixed exchange rates call for a new approach to economic policy

(SZ) Although it was responsible for exceptional growth in the world economy, the international monetary system carefully built up between 1944 and 1958 has collapsed. The system also helped to resolve contentious issues between governments at a practical level and at least to limit the use of foreign trade instruments for directly political purposes and foreign policy instruments to secure economic advantages.

by Hans Möller

Munich, 10 September — The Bretton Woods system undoubtedly had its shortcomings, but ultimately — just as, for instance, for the market economy in general — the crucial question is whether any better system is available. We overlook the fact that there are not actually any optimum solutions to many problems, only solutions that are more or less unsatisfactory, and, if we have no system at all, we end up with selective interventionism in the worst of all possible worlds.

Very few of the international monetary system's academic and political critics have, to date, gone to the trouble of working out even the basic principles of a different international monetary system and considering how it would operate. The Bretton Woods system has been critically scrutinised, but the conclusions needed to keep it workable have not been drawn. Individual countries have resorted to self-help measures, without considering their implications beforehand.

Mistaken belief

It is no accident that the dramatic foreign trade decisions in the Federal Republic and the USA were primarily motivated by domestic economic considerations. In both countries, the foreign trade crisis was clearly used to create a positive psychological effect on public attitudes and in fact on the decisiveness of the government team itself — even though it had been known for 20 years that, with a worldwide system of fixed exchange rates, a domestic economy cannot be totally independent.

The great hope now being held out for the immediate future is an international monetary conference. Desirable though it might be to set up a reformed international monetary system in the near future, I do not believe this will work. Many, mistakenly believing that the old system would then be able to function again, are contemplating going back to fixed parities and simply altering them. This illusion is fostered by the view that the difference between exchange rates and their equilibrium values is at the root of all monetary problems and all that needs to be done is to eliminate those differences by altering the exchange rates.

That is a false assumption; a fixed exchange rate system is specifically based on the principle that the other relevant economic parameters are changed in such a way that the market forces on the foreign exchange markets are in balance with the parities established. Many of the monetary crises over the last 20 years have been caused by attempts to prevent this by pursuing domestic economic policies that were purely short-term and often only ostensibly the 'best' policy. The deciding factor, therefore, is whether there is a determination to allow or introduce a domestic economic trend to be reconciled with fixed exchange rates and economic trends in other countries.

Certainly, a return to the old parities would ultimately be undesirable for the world economy. It would resolve the present crisis only if inflation in the rest of the world accelerated so quickly and effectively that it outstripped American inflation. That would be the only way in which the American economy could become competitive again with the old parities. Even then, success would not be guaranteed, always assuming that the rest of the world was prepared to make such a sacrifice. The main problem in the current crisis is inflation in the USA, and an even faster inflationary trend in the rest of the world would, in all likelihood, sabotage the successful anti-inflationary measures in the USA and plunge the world into a maelstrom of currency depreciation.

Everyone trying to gain an advantage

If the rest of the world wants to support the anti-inflationary measures in the USA and, at the same time, prevent the USA from now introducing its own foreign exchange controls, as it did in the first decade after the Second World War, revaluation against the dollar remains the only solution. Revaluation of as many major world trade currencies as possible would therefore be essential for successful development of the world economy, but it would not be sufficient for the Bretton Woods system to function again.

Whatever the advantages of concerted revaluation might be, the previous attitude of many countries suggests that it will either not happen at all or will remain too limited to be really effective. Each country is tempted to gain a competitive edge over the others and even over the USA. The haggling over new parities would inevitably place a severe strain on political and economic relations between the Western states.

This situation also rules out the possibility of devaluing the dollar against gold. Apart from the increase in the gold price, which is in itself undesirable, the parity of the dollar against the rest of the world could be altered in this way only if it was agreed beforehand by how much the dollar should be devalued and whether and by how much the other countries could devalue. That would be equivalent to concerted devaluation by the rest of the world. Neither option has much chance of success.

So what can be done? In my view, the only alternatives, as a temporary arrangement, are the decontrol of exchange rates for as many countries as possible and the acceptance of foreign exchange controls by the USA. In this situation, decontrol is the lesser of two evils compared with full foreign exchange control by the USA, since other countries would soon then follow suit. Initially, the decontrol of exchange rates would simply mean ending foreign exchange controls, and they could in no circumstances be reintroduced. This would be impossible without decontrol. American protectionist measures would have to be abolished as a *quid pro quo*.

This temporary arrangement would have several advantages. It allows enough time for discussion of and agreement on a reformed international monetary system. If, as I would hope, this system leads to fixed exchange rate parities, the resulting exchange rates would provide a suitable starting point for refixing them. If the new system is to be set up on the basis of flexible exchange rates, experiences with freely floating exchange rates could be compiled for a limited period and applied so as to create a permanent system.

Breathing space for the USA

The USA would also be given something of a breathing space so as to curb domestic inflationary trends. Long-term agreements on reform of the international monetary system are unlikely while the strong inflationary trend in the USA continues. This should not be taken as an argument for creating a permanent system of flexible exchange rates; a deliberate and soundly based re-commitment to fixed exchange rates by the major world trading countries could be important in curbing future inflationary trends. A fixed exchange rate system, however, can operate properly only if no one reserves the right to alter the rates at any time.

At the same time, this shows the extent to which the Western economy is still dominated by the USA. Empty protests are no solution; we must remember that the USA is still a political guarantor of the free world economy in the West and is currently finding this a heavy burden to bear. It has certainly not deliberately contributed to the disastrous increase in inflation over the last ten years. Other countries and governments have been in a much easier situation and have still made mistakes.

There was a saying in the 1950s, ‘When America sneezes, Europe catches a cold’. The USA was still in a much more dominant position at that time. Nowadays, the economic influence of other countries has grown and American economic policy is not as independent as it once was. For over ten years now, economists have agreed that a coordinated and properly harmonised economic policy is essential for the successful development of the world economy. There is no shortage of coordinating bodies, but experience shows that real coordination is still lacking.

Coordination needed

In this situation, coordination needs to begin on a small scale. Given the close economic and institutional links in the EC, coordination is both essential and likely to succeed. With a common EC policy, it would be much easier to resolve the present crisis and to coordinate the West's economic and monetary policy when that later became necessary. It would also be in the interests of the USA, which are well appreciated.

With the introduction of the temporary arrangement outlined above — ending foreign currency controls and decontrolling exchange rates in principle — EEC Member States would also have ample time to consider whether and how they should stabilise exchange rates in the Common Market. The simple formula of stability at home and flexibility abroad is not enough on its own for a Community policy. Ultimately, it has to be decided how external monetary policy is to be implemented for the Community and whether and in what circumstances intra-Community monetary relations may be changed.

The issues to be resolved in that context are to some extent the same as those for the reform of the international monetary system. In particular, they include the future role of international credit facilities. The growing freedom for these facilities — for which there was, moreover, no provision in the theoretical Bretton Woods system — has made the major world trading countries much more interdependent in monetary terms. The ultimate cause of the surprisingly strong inflation in the last five years and of the many inconsistencies in the international monetary debate (for instance, the incorrect diagnosis of the currency reserves requirement) is that the importance of international credit facilities is not fully recognised. Still less have their economic policy implications been considered.

It is certainly understandable, in the circumstances, if some countries try to restrict the decontrol of exchange rates to the movement of capital and to regulate this by ad hoc intervention. This seems risky, however, because it can all too easily lead to real foreign exchange control and make long-term arrangements at a later stage more rather than less difficult.

Clearly, therefore, reform of the international monetary system calls for more than just changes to the old system. A hasty approach, trying different ways of curing the symptoms and putting forward specious short-term solutions would only make the crisis worse. Simply allowing the present unresolved state of affairs to continue is equally risky. The temporary arrangement, with the abolition of protectionist trade restrictions in the USA, no further exchange controls by the other countries and decontrol of exchange rates in principle, would therefore be desirable, provided that each country has an intervention right for its own currency.