

THE CURRENT POSITION

What, then, is the current state of disequilibrium in the world that suggests the need for any exchange rate changes?

I believe the following basic disequilibrium patterns would be conceded by most observers of the international financial scene as of August 1968:

1. The French franc is overvalued with respect to the dollar.
2. The Deutschemark is undervalued with respect to the dollar. The Germans have recognized that they have to expand or else upvalue the mark; they have apparently chosen expansion. The French have said they would resist devaluation, but they have imposed controls of such a comprehensive scope that devaluation in the future may be necessary to remove them.
3. The U.K. position is less clear. The overhang of sterling liabilities is a mortgage on their resources and many countries now want to leave the sterling area. U.K. vulnerability is reflected in their high interest rates, the discount on forward sterling, and the exceedingly weak reserve position. But British labor is not overvalued. Britain would be competitive if she could restore confidence in her capital position and an increase in reserves at the going exchange rate.
4. The U.S. position is governed primarily by the *system itself*. For ten years we have heard much discussion of the U.S. balance of payments. The issue is sometimes posed in terms of whether the U.S. has a deficit or surplus. But these terms have rather little meaning for the U.S. Since the change in the system last March the world has effectively moved onto a dollar standard. Access to U.S. gold stocks has been denied the private market, and it is effectively, if not formally, denied other central bankers. The primary question for the U.S., therefore, is whether U.S. financial policy is too expansionary or too restrictive, not whether there is a deficit or surplus in the U.S. balance of payments.

Looked at in this way we have to ask whether the U.S. policy is excessively inflationary. That it was a few months ago was certain. But it is not so certain today.

Upvaluation of the mark and devaluation of the franc would be a step toward equilibrium; that much I believe is certain. Alternatively, deflation of the money stock in France and inflation of the money stock in Germany, would help restore balance. But there is no compelling reason for a change in the price of the U.S. dollar in terms of foreign currencies. No country in the world wants to compete against a devalued dollar, with the possible exception of Germany.

The U.S. is, to be sure, committed to a social and economic policy that will lead to a higher price level than currently prevails over the next two or three years. It would not be possible to end the inflation quickly without bringing on a depression and it would be disastrous for the U.S. to try to do so. But the case for devaluation has to rest on the need for a change in the system and not on the need to make any drastic corrections for overvalued labor in the U.S.

In short, except for Germany, and perhaps Holland, Switzerland and Italy, I see no country that would welcome an exchange rate change. It follows, I believe, that if the U.S. were to lower its par value at the I.M.F., every other member of the Fund would follow, with the possible exception of Germany, Holland, Switzerland and perhaps Italy. But these countries already have the option of appreciation, and, so far, they have rejected it. Therefore, I doubt whether even those countries would resist the *de jure* devaluation of their currencies. In short, there is simply no point to U.S. devaluation to change exchange rates because the devaluation would be followed by the rest of the world. To put it another way the U.S. cannot devalue against other currencies unless the other countries will allow the U.S. to do so. There would be little or no point, therefore to a devaluation of, say, 10 per cent.

IV. DEVALUATION AND THE SYSTEM

A far more respectable case can be made for devaluation to restore the gold exchange standard. The prerequisite for such a system to operate effectively is for gold to be worth less as money than as a commodity. There are three ways of bringing this about. One is to wait until South African supplies to the market are resumed. At such a time gold would then be used as a money along the lines expressed by Gresham's law.

A second method would be a new strategy of intervention in the gold market by the central banks. Collectively or individually, they could flood the market with existing gold stocks and determine whatever price they want.