THE REPERCUSSIONS OF THE INTERNATIONAL MONETARY CRISIS IN THE BALKANS AND A POSSIBLE REMEDY

Whenever speaking, writing or thinking about the international monetary crisis we have the tendency to believe that it affects about a dozen countries and forget that all the world feels the repercussions. This applies also to South Eastern Europe and accordingly this essay will deal:

First with the roots of the phenomenon,

second with the factors which intensified same in view of the refusal of those concerned to act in the way proposed by the author at the St. Anton conference of the International Economic Association in 1971 and many times later,

third with further developments 1972-73,

fourth with effects in the Balkans.

Conclusions constitute the last part.

I

Everybody got accustomed in the last five years or so to call certain developments in the international monetary markets an international monetary crisis. The latter makes a lot of people busy in buying gold or in moving funds from one place to the other whilst central banks and governments first try to prevent these moves without imposing official foreign exchange control, second to propose with the help of their technical advisers, at least as a rule, unworkable solutions of a problem which is certainly not simple.[1]

The forecasts of prospects of a currency are usually based on the overall appearance of the balance of payments of the country concerned during the last years, on the development of its gold and foreign exchange reserves, on

1. Cf. S.J. Katz, *The Case for the Parvalue System,* Princeton 1972 p. 5 and even more R.J. McKinnon, *Monetary Theory and Controlled Flexibility in the Foreign Exchanges,* Princeton 1971, pp. 31-32.

the expectation of future developments similar to those which were noticed recently and on the development of prices and wages in comparison with their evolution abroad. Another factor of great importance to businessmen, savers hoarders, investors and speculators but not to the majority of academic economists, at least in the English speaking countries, [2] is the evolution of the price of gold and the repercussions of its expected fluctuations even if the latter do not materialize on the leading currencies.

Under the influence mainly of academic economists the United States Government had decided that the price of gold as fixed early in 1934 is not to change.[3] This decision would have been right in a world of stable prices and stable exchange rates but not in a world of rising prices and of changing parities. In the latter the stability of alone the price of gold which is not only the best available means of preserving purchasing power untaxed and unnoticed but also a very important raw material for dentists, jewellers and a growing number of industries showed that this was unnatural and could not be preserved. Of course the biggest gold holder, the United States government, was adamant in its decision not to revalue gold but experience teaches that even the strongest government cannot keep indefinitely on wrong decisions which have to be amended some time under the influence of economic laws. As long as the gold stock of the United States government seemed unlimited those foreseeing increased gold prices had to wait. When however the United States, gold stock started falling continuously and when it amounted to a little over $ 10 billions, well informed sources declared somewhat ambiguously that the government responsible for the safety of the United States could not afford to leave their gold stock fall lower than $ 10 billion and the people involved all over the world considered that the appreciation of gold would materialize within a very short time.

As a matter of fact on March 18, 1968 the gold market was divided in two sectors. Anybody, provided he is not prevented by the laws of his country of residence from owing or buying gold, could as freely as before buy and sell same with the substantial difference however compared with the period just ended that prices would fluctuate and the central banks' gold pool which was

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2. Cf. Al. Kafka, *The International Monetary Fund: the Second Coming,* Princeton 1972, p. 31 and F. Machlup, "The Book Value of Monetary Gold." Reprinted from Banca Nationale del Lavoro *Quarterly Review,* December 1971, Rome.

3. Cf. G. Haberler, *Money in the International Economy,* Harvard University Press 1965, Preface page 2. He expected a short run blow to confidence with initially deflationary consequences from a drastic rise in the gold price. Cf. also John Williamson, *The Choice of a Pivot for Parities,* Princeton 1971, p. 24.

dissolved would not interfere any more. To the general astonishment the ounce of gold rose only from 35 to 43 $ and fell gradualy to 34,80 at the end of December 1969. The expected gold price of United States dollars 70 per ounce as foreseen by two wellknown economists [4] did not materialize yet. This was due to the profit taking of gold buyers with funds they borrowed and who did not want to wait any more inasmuch as interest rates had risen to excessively high levels in the western world under the influence of the deflationary policy [5] of the United States applied until 1970. Later on however the price of gold started rising and is now (March 1973) around $ 83 per ounce.

II

The change of the gold policy of the United States showed that their government was not able to resist indefinitely the pressure of economic forces inasmuch as the reluctance to increase the price of gold was due to non economic motives, namely the desire of withholding profits from two great gold holders: the Soviet Union and South Africa and of course from all those who proved right in their forecasts. This development in the case of gold induced holders of dollar balances in the United States who are not allowed by law to buy and hold gold to find the currency which ought to be revalued in order to reduce the surplus of the balance of payments of the country concerned,[6] with the intension to transfer funds there and ripe in dollars [7] the benefit of revaluation to be derived. It was not difficult to find out that Western Germany was the case country as her gold and foreign exchange reserves were constantly increasing and as her overall balance of payments was constantly showing a surplus. The political parties which got the majority in the Western German elections of 1969 were in favour of revaluation [8] with the hope that by revaluing Western Germany would be able to:

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4. M. Heilperin and Jacques Rueff. For a stronger presentation of this idea cf. A.N. Rugina, "Leon Walras contre J.M. Keynes," *Revue d'Economie Politique* 1970, pp. 201-220.

5. Up to a certain degree it was neutralized by the large inflow from the Euro-dollar market. Cf. F. Machlup, *Changes in the International Monetary System*, Princeton 1971, p. 11.

6. That would be revaluation under the threat of appreciation according to the distinction of F. Machlup, *The Alignment of Foreign Exchange Rates*, New York 1972, p. 32.

7. They would have been perhaps discouraged by a widened band of exchange rates. Cf. G.N. Halm, *Toward Limited Exchange Rate Flexibility*, Princeton 1969, p. 12 and T. de Vries, *An Agenda for Monetary Reform*, Princeton 1972, pp. 13-14.

8. They were reinforced in this policy by a great number of academic German econo-

1) reduce the overall surplus of the balance of payments

2) avoid the further increase of the gold and foreign exchange reserves of their central bank putting so a brake to requests by foreign governments of loans, gifts etc.

3) weaken the inflationary pressures in Western Germany as they expected a fall of exports, profits, employment, investment and consumption. [9]

Accordingly the D Mark was revalued in terms of the United States dollar by about 9% in November 1969. All those who foresaw this step secured an untaxed profit and withdrew their mark balances on the basis of the new dollar rate. The withdrawal of funds from Western Germany was so substantial that the West German Central Bank had to have recourse to the International Monetary Fund in order to avoid the sale of gold.

These substantial profits taught everybody that independently of any official denials a country proceeds to revaluation whenever its balance of payments shows a substantial surplus for a relatively long time. Let me add that those who abstained from this deal regretted it and intended not to lose the occasion once more.[10] Everybody seemed however to have forgotten that a surplus country can always avoid revaluation by sterilizing the proceeds in local currency of these transfers and by lending the foreign balances to the country from where they were transferred. As a matter of fact the West German government could very well avoid revaluation

a) by requesting its central bank to use increased dollar balances for the purchase of Treasury Bills of the United States government[11] or for loans in the Euro-dollar market,[12]

b) by keeping secret the dollar balances bought by the West German central bank,

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mists, cf. H. Giersch, *Growth, Cycles and Exchange Rates: the Experience of West Germany*, Stockholm 1970, p. 33.

9. We have to consider that in Germany the national propensity to inflation is very low. Cf. G. Magnifico, *European Monetary Unification for Balanced Growth: A New Approach*, Princeton 1971 p. 12.

10. Except if forbidden to do so. Cf. D.J. Delivanis, *Fluctuating Exchange Rates*, Athens 1972, p. 14.

11. Cf. in this connection the brilliant essay of F. Machlup, *Involuntary Foreign Lending*, Stockholm 1965 and particularly pp. 14-15, 18-20, 26, 38, 47, 62-3, 99, 107, 111-6, 121-2, 125 and 128. The purchase would be easier with an exchange guarantee.

12. Cf. S.W. Black, *An Econometric Study of Euro-dollar Borrowing by New York Banks and the Rate of Interest on Euro-dollars*, Princeton 1971, pp. 83-8.

c) by the prohibition of any interest payment to foreign holders of D Mark balances, of the use of the amounts involved for any loan and investment either of the foreign holder or of the German bank holding the balance,

d) by compelling same to transfer all D Mark balances of foreigners to the West German Central Bank.

The surplus of the West German balance of payments continued as the price and wage increase in Western Germany was neutralized in many cases by increased productivity, by technical progress and if needed by adequate price rebates;[13] so inflationary pressures were not curbed as expected by the partisans of revaluation. Accordingly, the West German Central Bank increased substantially its interest rates. Thus West German firms in need of credit preferred to get same from the Euro-dollar market where interest rates had dropped substantially as credit available in the United States increased and interest rates were cut there in the early seventies. The West German firms involved of course needed D Marks and not dollars and so they sold same on a great scale through their own banks to the West German Central Bank in the second half of April 1971 and in the early days of May 1971. Instead of buying at once Treasury Bills of the United States of America government or lending dollar balances at the Euro-dollar market avoiding carefully publicity, the West German Central Bank did not hide that it had been obliged to buy substantial dollar balances. The result was that many holders of dollar balances rapidly guessed that a new revaluation (the second after November 1969) had to be expected in West Germany and accordingly converted on a big scale in D Mark. The West German Central Bank was allowed following this development by its government to stop buying dollars and leave the D Mark float; the same happened in the Netherlands, whilst Austria and Switzerland revalued their currencies by about 11%. The pressure on the United States dollar however continued and the United States on August 15, 1971 violated first the obligation they assumed not to prevent the Federal Reserve Bank of New York from redeeming in gold the dollar balances of foreign central banks, second their obligation not to increase without agreement with their trade partners their custom duties by introducing unilaterally a surcharge of 10% on those of manufactured commodities. Of course these steps could not be expected to yield results worth mentioning before six months but were very dangerous as they could constitute the preamble of

13. Cf. D.J. Delivanis, *La réévaluation*, chapter II, under preparation, J. Molsberger, "Exportwirkungen der DM Aufwertung von 1971," *Wirtschaftsdienst*, September 1971 pp. 483-7, of the same, "Hat die deutsche Aufwertung von 1969 den Export gebremst?" *Wirtschaftspolitische Chronik* 1971, Heft 2, pp. 23-43,

a trade war between the United States and their NATO allies.[14] The desire to avoid such a disastrous political development led to the Smithsonian agreement of December 18, 1971[15] in virtue of which the United States increased the dollar price of gold by 10% whilst the other members of the group of ten appreciated their currencies both in terms of the United States dollar and of gold proving for the third time after 1969 to the dealers in international monetary markets that it pays to speculate on parity changes. It is well known that the Smithsonian agreement was a political deal and that some at least of the countries belonging to the group of ten accepted parities of their currencies which they could not keep. They proceeded so in order to persuade the United States government to abolish the 10% custom duties increase imposed on August 15, 1971.[16]

III

1972 and the early days of 1973 have been relatively calm on the international monetary markets with two exceptions however: the United Kingdom and Italy. Both these countries were obliged within six months after December 18, 1971 to leave their currencies float, the first without restrictions the second by starting three different rates and by curbing transfers abroad wherever this proves to be possible. The supply of dollar balances in the Western European markets always exceeded demand and so the Western European central banks were often obliged to buy the surplus as long as they wanted to avoid the appreciation of their own currencies in terms of the United States dollar and thus losses to be incurred by their exporters. Unluckily they did so with a lot of publicity which ought to have been avoided if it was considered worth while to appease the fears of the public, weaken the tendency to speculate of those who have the know how and secure the normal settlement of international claims without undue leaks and lags. It is high time to understand that even before the 15th August 1971 and even more afterwards the world's monetary system is a dollar standard[17] and that no country in the world can apply on its purchase

14. Cf. the excellent essay of M.V. Posner, *The World Monetary System: a Minimal Reform Proposal*, Princeton 1972, pp. 38-39.

15. Cf. rather infavourable comments by F. Machlup, *International Money: the Way Forward Now*, Princeton 1972.

16. The latter took advantage of the impossibility of getting replaced by another country or a consortium of countries in the role of reserve currency country. Cf. F. Modigliani and H. Askari, *The Reform of the International Monetary System*, Princeton 1971, p. 28.

17. Cf. G. Haberler, *Prospects for the Dollar Standard*, Washington D.C. 1972, pp. 1-2,

and sale policy of dollar balances the principles applied to those of any other asset. It is a generally accepted and wise policy to avoid the acquisition of any asset on an abnormally large scale and to try to divide risks. This does not apply however in the case of dollar balances as the only eventual result of the interruption of the latters purchase is a great anomaly in international settlements and an obstacle to the expansion of world trade both in visibles and in invisibles which contributes so much to the improvement of the living conditions all over the world. The proof that dollar assets and dollar balances are indispensable for the smooth operation of international settlements has been obtained with the failure of the European Economic Community countries to replace same even in the settlements between its members. It follows that as long as the offer of dollar balances can be traced

1) to the oil producing countries whenever they hope to exploit exchange rate fluctuations which they contribute to create very often for political purposes,

2) to the repatriation of funds belonging to inhabitants of Western European countries as long as they expect a devaluation of the United States' dollar in terms of their own currencies and as long as they believe exactly the contrary of what induced those responsible in the years 1934-39[18] to shift their balances to the United States. This may be the latters' conciliatory policy towards the big communistic powers and even the smaller ones which seems to exclude the possibility of a major war,

3) to the speculative transfers of the inhabitants of the United States, of the firms and the banks established there in order to ripe the profits of a new devaluation of the dollar of the United States. These are expected to be sufficiently important to cover easily the 2% per three months Swiss tax on foreign deposits exceeding 50,000 SF and the prohibitions for foreigners to lend and to invest in force in the Netherlands, Switzerland and Western Germany.

The Western European central banks have no other alternative except either to induce the United States to rise their protective duties or to leave the dollar to depreciate so much that European exporters will be unable to compete with those of the United States. It is really not possible to assume the terrible political risks involved just in order to comply with rules which can not be enforced in the case of the key currency inasmuch as the latter has

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16-17 and *US Balance of Payments Policy and the International Monetary system*, Washington D.C. 1973, p. 193.

18. Cf. F. Machlup, *Euro-dollar Creation: a Mystery Story*, Princeton 1970, pp. 255-7.

proved to have no substitute that can be considered seriously in the real world of ours.

IV

As far as the States of South Eastern Europe are concerned we have to consider that their current balance of payments is not in equilibrium as payments abroad are increased by the needs of their economic development.[19] This deficit is covered by capital inflow and this is as a rule in United States dollars except in those rare cases where capital is supplied by the Soviet Union. The latter does not invest only in the countries under communistic rule as it tries, of course for political reasons, to invest also in Greece and Turkey whilst Yugoslavia is very keen to attract western capital by necessity in United States dollars. It follows that if the Western European central banks continue their fallacious dollar policy which will eventually lead to a reduction of international capital flows, the Balkan countries and particularly those outside the Iron Curtain will face the danger of getting deprived of the capital inflow which enables them to secure a satisfactory rate of growth. As a matter of fact the gold and foreign exchange reserves of their respective central banks cannot cover for long the deficit of their current balances of payments and the interruption of the capital inflow will endanger their external equilibrium. Of course the burden of their dollar debts will be reduced but it has to be noted that for the Balkan countries on both sides of the Iron Curtain the United States dollar is still a scarce currency as some of them showed by remaining faithful to the dollar rate prevailing before troubles and doubts rose about this key currency. Of course in this way the Balkan countries whose intercourse with Western and Central European countries is substantial are exposed to a deterioration of their barter terms of trade and to a stronger price rise as by keeping the old dollar rate they devalue their currencies in terms of the Western and Central European currencies. The increased pressures derived from this development in combination with the continuous price increase in these Central and Western European countries will of course affect very unfavorably the price and wage structure of these countries and the continuation of their development with a satisfactory rate. If on the other hand these countries would revalue in terms of the United States dollar the capital inflow will substantially fall and create acute problems of external equilibrium.

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19. They are not always considered, cf. R. Ossola, *Towards New Monetary Relationships*, Princeton 1971.

For the time being (March 1973), I may conclude that the devaluations of the United States dollar in terms of gold and even more of Western and Central European currencies has led to a deterioration of the barter terms of trade of the Balkan countries, to a diminuation of their ability to compete with countries whose currency has been devalued in terms of the United Stades dollar, last but not least to the strengthening of inflationary pressures raging within the Balkan countries. The latter however for the time being has to be considered a minor evil in comparison with the developments that would have been unavoidable if the Balkan countries did treat their dollar rate as are doing the Central and West European countries.

Conclusion

The idea that the dollar of the United States was overvalued and that the reduction of its gold content contributes to the equilibrium of the balance of payments of the United States of America does not correspond to realities as every devaluation of the dollar of the United States is followed within a very short time by the increase of all dollar prices. This is the consequence of the sellers' market prevailing since 1945 and of overemployment in the western world. It follows that every devaluation of the United States dollar increases the amounts needed for the settlement of international claims and that the continuous reductions of the United States dollars' parity do not lead to any real result but of course cause many changes in the book-keeping departments all over the world. There is no doubt that the monetary anomalies of the years 1971-73 do not contribute to the development of the world trade both in visibles and invisibles, whilst the necessity of invoicing in local currency leads to the continuous increase of forward deals in various currencies.[20] This of course rises the costs for commodities traded and thus intensifies inflationary pressures which governments are supposed to try to weaken. The same results will be achieved if a number of European currencies are to float together in terms of the United States dollar with the advantage however that at least the relationship between these currencies will be stable provided

20. The Bank of Greece has been obliged by the exporters' pressure to start preparing deals in forward exchange which were not practiced in Greece until March 1973. For the problem at the beginning cf. M. Negreponti-Delivanis, *The Pressure on the Dollar*, Leyden 1964.

the central banks concerned are able to achieve this stability.[21] The forthcoming weeks will teach us a lot. We have to note that after every change the illusion of market equilibrium having been reached is due to those who sold dollar balances they do not have and who cover themselves. The foreign exchange market starts then for a new disequilibrium as long as so many people all over the world are certain that a new realignment is in store independently of official denials. The repercussions of this uncertainty and of these changes in the Balkans whose intercourse is mainly with European countries and where the dollar balances constitute an indispensable reserve for the smooth operation of their payment system without possibilities of replacemant are strongly felt.

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21. Cf. in this connection appropriate doubts of W.M. Corden, '*Monetary Intergation,*' Princeton 1972, pp. 8-16 and 39-41 and of M. Friedman, *Oikonomikos Takydromos* of March 15, 1973 (in Greek).

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