THE INTERNATIONAL CURRENCY CRISIS

Speech delivered to Incorporated Insurance Brokers of S.A. Ltd.

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1. For the last quarter of a century, international payments between countries has been on the basis of fixed parities between countries — parities that could in terms of the International Monetary Fund rules only vary 1% up or down on the currency's national parity. It is true Sterling was devalued in this period and the German Mark and the Dutch Guilder revalued — but the new level was immediately fixed again. With a fixed parity the monetary authorities — usually the Reserve Banks, must always be prepared to buy or sell their currencies at the fixed rate, allowing of course, for the 1% up or down movement.

2. Now, all of a sudden, thanks to President Nixon's recent actions, important world currencies like Sterling, Yen, Mark, Guilders, Lira and Francs, are all floating. That is, their value depends on demand and supply, subject however to intervention by the Monetary Authorities when they think the savings are getting too wide or wild.

3. Before one can understand what it is all about, one must first have an idea how international indebtedness, that is debts between nations, is settled. Foreign trade and money transactions between two countries hardly ever balance. Thus payments between South Africa and say, Germany, never balance exactly. We buy far more from Germany than they do from us. But, because the Rand is not an international currency, the Germans won't hold Rands for the difference. Before the last war, they were prepared to take gold or Sterling in settlement. Gold for obvious reasons, and Sterling because the United Kingdom, for a very long period, had been the greatest international trading country in the world. But during the war, many countries amassed vast holdings of Sterling, and Sterling came under suspicion. The fear arose that these debts might never be redeemed, or redeemed in greatly devalued currency. And there was simply not enough gold available for settling international transactions — and in any event, the great bulk of monetary gold was held in Fort Knox in America, and with America's favourable balance of payments, seemed permanently immobilised.

4. A great monetary conference was held at Bretton Woods in 1945 to settle the world's monetary mechanism. Out of this conference came the so-called gold exchange standard based on the dollar at 35 dollars to the ounce. What this meant, was that the parities of all other currencies were related to the dollar, and the dollar was valued at 35 dollars to an ounce of gold. These parities could only move within very narrow limits, 1% each way, limits controlled by the Reserve Banks of the member countries of the International Monetary Fund. If a country

wanted to change its parity by more than these limits — i.e. devalue or revalue, it had theoretically to get the approval of the I.M.F.

5. The dollar therefore became a means of international payment, a reserve currency, just like gold. But Sterling was not dethroned and also remained a reserve currency. All countries therefore had three forms of international reserves; gold, the dollar and Sterling, held by their central banks, with which they effected international payments between countries.

   These constitute international liquidity, the cash that countries need to settle international payments resulting from international trade and capital movements. In April 1968, Special Drawing Rights on the I.M.F. have become a fourth form of international reserve, but its role is still small compared with the others. But as I will indicate shortly, these might become of great significance in future. I will deal with S.D.R.'s more fully below therefore.

6. Under the Bretton Wood's gold exchange standard, the fixed yardstick of the value of currencies, was therefore gold. For instance, if a country like France started doubting the value of the dollars she received for her exports, (which she indeed did in recent years), she would insist on the monetary authorities of the U.S.A. exchanging these for gold, — one ounce for 35 dollars held. Any other currency would have to be exchanged first, and then to gold. Of course, individual citizens have not had this right for many years. But at least, monetary authorities had this right.

7. It is this right to convert dollars into gold that President Nixon has now suspended and thereby thrown international currency markets into a tizzy. If anyone outside of America holds dollars of which he is suspicious, all he can do now is to convert it into a stronger currency, e.g. the Yen or Mark. But if the Reserve Banks in these countries bought all the dollars offered at the fixed parities which existed, they would have been flooded with unwanted dollars. Thus on one day in May this year, in a matter of 35 minutes, one billion dollars were converted into Deutsche Marks.

8. The only way the strong currencies could prevent this flooding of unwanted dollars, was to unpeg their fixed parities and let demand and supply up-value their currencies in terms of dollars, either for all dollars offered, or as in the case of France, only for dollars not originating from French exports and commercial transactions.

9. But it has not been a free float. Most of the countries with large exports to the United States of America, like Japan who is responsible for nearly half the deficit of the U.S.A. on trade account, do not want to jeopardise their exports by letting their currencies float up too far. They have thus discouraged the inflow of dollars now arising from exports, and intervened to limit it to about a 6% to 7% float. Hence the German Finance Minister's new term of a "dirty float". Although the float upwards against the dollar by the main trading currencies of the world is not uniform (e.g. Sterling is about 3% up), the average is probably of the order of 6% or 7%.

10. As Rand is now linked to the dollar, our defacto devaluation vis-a-vis the rest of the world is now also of this order. On the other hand it will make imports dearer and exports cheaper. This should give us some assistance in improving our balance of payments.

11. But the dollar has in fact devalued by more than this, because of the 10% temporary charge on imports into America, which because it does not apply to all goods, averages out to a further 6% or 7%. Vis-a-vis the rest of the world the de facto devaluation of the dollar is thus of the order of 12% to 14% which should assist very considerably in correcting the U.S.A.'s trade account.

12. But the Americans are clearly not satisfied with the degree of floating that has taken place. They for instance, seem to expect that

the Yen should appreciate by 15% and that many of the restrictions on imports from America should be lifted. Also that Western Europe and Japan should carry a bigger burden of the free world's defence commitments, only then will they abolish the 10% surcharge on imports.

13. The main trading countries of the world, whilst sympathetic towards the Americans with their balance of payments problem, feel that the Americans should not leave all the correcting measures to them. In particular, they feel that the dollar should be devalued in terms of gold by say pushing up the price of gold to 38,50 dollars per ounce — or a 10% devaluation. The Americans are resisting this pressure — because of the political myth that the dollar is as good as gold. Whether they will yield or not, is anyone's guess. If they do, it will be quite a psychological boost for gold — but this is apparently the very reason why they oppose it.

14. The American attitude towards the monetary price of gold seems to me completely irrational — a compound of political fallacies. They still sit with the world's largest monetary gold stock worth 10,2 billion dollars and constituting 80% of their foreign exchange reserves. They won't let go of it, but they won't upvalue it either, despite pressure from the rest of the world. At this stage of international monetary development, it appears essential that currencies must still have a yardstick of value, namely, gold. But such a monetary yardstick only has value if the monetary price of gold is well above its free-market industrial price — so that countries holding it can be assured that they will always get good monetary value for it, when it is required to acquire foreign currencies.

15. For all these reasons, it would make good economic sense if the price of gold was for instance doubled in terms of dollars, and to a lesser extent in terms of other strong currencies. It would also give international trade the extra liquidity it would require if the Americans really started righting their balance of payments. For the rapid growth of international trade, in the past decade, has depended very largely on the liquidity provided by the massive flow of dollars into the reserves of the great trading countries like Japan and Germany because of the imbalance of payments of U.S.A. However, the sensible and practical is not always acceptable to politicians. An alternative to dollars will have to be provided to look after international liquidity, when the U.S.A.'s balance of payments is corrected, and it does not look as if this will be done via gold. Last week, Mr. Barber, the British Chancellor, suggested that this should be done via S.D.R.'s.

16. I have already mentioned the creation of S.D.R.'s in 1968. Briefly, a special drawing right, is a credit account allocated to the member countries of the I.M.F. Whilst not convertible into gold, its value is expressed as equal to o,888671 grams of gold, which makes it equal to a dollar. Against their S.D.R. credit, members can buy convertible currencies of any other member — he is then of course debited with the equivalent amount of S.D.R.'s. As at present, the amounts of S.D.R.'s are very limited in relation to total world liquidity. Its use is also circumscribed and no member need accept more than twice the amount of its own allocation.

17. Mr. Barber now suggests that S.D.R.'s be further developed as follows:
    (a) Currency parities would be expressed in terms of S.D.R.'s, instead of dollars, so that the American dollar could be devalued (when America wanted it to be), in a normal way just like any other currency;
    (b) S.D.R.'s would become the main asset in which countries would hold their reserves, with holdings of Sterling and dollars and all other currencies largely confined to working balances;
    (c) The IMF which manages the total of S.D.R.'s, should then be able to provide for the controlled creation of

adequate but not excessive world liquidity.

18. These proposals if accepted, would downgrade gold as an intermediate currency. But gold would probably still be the value yardstick of S.D.R.'s. The dollar price of gold would then be increased indirectly via the S.D.R. gold content, thus saving American face.

19. The only thing that is clearly emerging from the currency crisis, is that exchange rates will never be as inflexible as in the past. Even if fixed parities are re-established, they will fluctuate within much wider bands. Possibly 3% on each side of parity compared with the present 1%.

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