Exchange Parities After World. War II

FIXATION of exchange rates . has been as much a problem after World War II as it was after World War I with this significant difference that the lesson of the inter-war period, which had taught the folly of any one country trying to fix its own exchange rate without any concern for others, had been taken to heart. In fact in the later thirties, it had come to be recognised and accepted that if any important currency had to be devalued, it could be done successfully only by concerted action between a number of countries. The principle of joint action was exemplified when the franc was devalued after a long period of struggle in 1937. This was made part of a tripartite agreement for maintaining the exchange rates between the franc, dollar and the pound, to be implemented through the operation of stabilisation funds of the three countries.

This principle is the bedrock of the monetary mechanism set up after World War II, incorporated in the twin Bretton Woods institutions—International Monetary Fund and the International Bank of Reconstruction and Development.

Agreed, that no member of the IMF can revalue its currency beyond 10 per cent after prior consultation with the Fund and with its approval. This is not a small gain in itself, since it averts unilateral currency depreciation and also prevents competitive devaluation of the sort that plagued the world in the 'thirties.

Once the principle of joint action Is accepted, the next question that arises—and this is by far the more important—what is the proper exchange parity for a currency and how it is to be determined? In other words, what are the principles by which the equilibrium or par value of a currency can be fixed? There is, first, the question of a proper valuation and secondly, there is also the question that once par values are determined and accepted by international agreements—through the IMF or otherwise—how are these rates to be maintained in practice?

On the question of principles for determining exchange parities, the IMF has not been able to give an unequivocal answer or any lead at all. Perhaps, they have been wise in not attempting to lay down fixed or rigid rules for it. From the decisions taken by the IMF in the past and from an examination of the exchange parities that have been fixed on the present occasion, no clear principle emerges at all. The attitude of the IMF has been frankly pragmatic, if not that of expediency. And, as is inevitable, in view of the overwhelming influence of the U.S.A. on the Institution, the decisions have been swayed more by the pressure of American public opinion than by a consideration of the factors, theoretical and realistic, that should reasonably enter into them,. Perhaps the rates fixed may do the trick, who knows? In any case, it is too early to pronounce on the wisdom or otherwise of the decision announced last week. What the IMF has succeeded in doing has been to set up a mechanism through which joint consultation and an agreed decision can be arrived at and partially implemented.

Expediency rather than any clear principles were apparent when the IMF started operations and fixed the initial exchange rates towards the end of 1946. Stability of exchange rates was necessary to restore world trade and international economic relations. What rates were fixed did not seem to be so important. Anyway, the problem was much easier than after .World War I. For, during World War II none of the countries, not even those under German occupation, had allowed their exchanges to fluctuate widely. And the simplest thing to do was to accept the controlled rates which had been *in* operation during the war and which had been maintained after the termination of hostilities. None of the important countries had scrapped exchange control after the war.

The exchange rates announced by the IMS in December 1946 were neither the rates that could be justified by the comparison of the price levels in the different countries, whether one went by the wholesale prices or the cost of living index; nor did they profess to bring about an equilisation in the balance of payments of the respective countries, taking into consideration the changes that had taken place in their internal economies and in the outside world. The procedure was simple. The Fund agreement provided that unless either the Fund or the member country concerned objected, the initial exchange rate at which the Fund would commence operations in a particular currency should be the rate prevailing sixty days before the agreement went into effect. The rates finally agreed upon and announced in December 1946 were in every case the identical ones existing at the time the Fund made its call for information.

It was recognised that the initial par values may later be found incompatible with the maintenance of a balanced international payments position at a high level of domestic activity.

It was thought, that since the y/orld was short'' of goods, any rates would do which were not for the time being a great handicap to the sale of the exports of the countries concerned. But when production revived and countries experienced difficulty in selling sufficient exports to pay for their needed imports, the Fund "will have to recognise the unusual circumstances under which the initial par values were determined" and allow a revision. This statement from the Executive Directors of the Fund in their first annual report highlights the connection between the present devaluation and the emergence of the buyers' market.

The official rates initially fixed by the Fund bore little relation to the parity rates either in terms of wholesale prices or of cost of living, as will be seen from the accompanying table.

PARITY EXCHANGE RATES FIXED BY IMF, DEC. 1946

(In cents per units of foreign currency)

Member country	Parity rates: Wholesale price parity	Parity rates: Cost of living parity	Rates announced by the Fund
Belgium	—	(12/46) 1.52	2.28
Canada	(11/46) 120.33	(11/46) 118.45	100.00
Czechoslovakia	(11/46) 1.90	(11/46) 1.54	2.00
Denmark	(11/46) 18.54	(9/46) 19.34	20.84
Egypt	(7/46) 246.27	(7/46) 251.93	413.30
France	(11/46) 0.63	(9/46) 0.53	0.84
India	(8/46) 16.69	(11/46) 21.21	30.23
Netherlands	(10/46) 34.16	(9/46) 42.11	37.70
Norway	(11/46) 22.80	(11/46) 21.59	20.15
Union of South Africa	(9/46) 425.24	(9/46) 500.27	403.00
United Kingdom	(11/46) 467.59	(11/46) 549.46	403.00
	Current Rates		
Non-member countries:			
Australia	(11/46) 440.51	(9/46) 424.97	321.07
New Zealand	(10/46) 395.27	—	322.36
Sweden	(11/46) 24.66	(9/46) 24.11	27.82
Switzerland	(11/46) 18.77	(11/46) 21.86	23.36
Member countries for which rates have not been announced:			
Brazil	—	(11/46) 3.87	5.41
reece	—	(10/46) 0.0083	0.02
Italy	(11/46) 0.14	(9/46) 0.26	0.26
Poland	—	(10/46)* 0.23	1.00
Uruguay	—	(9/46) 74.94	56.27

Figures in brackets indicate the month and year for which the parity rate was computed,

* Admitted to membership later,

(From International Monetary Policies. By Metzler, Triffin and Haberler, Washington, Sept. 1947.)

In the case of India, with the 18s rupee and the sterling-dollar cross rate fixed at 4.03 led to a dollar rate of 30.23 cents for the rupee, while on the basis of wholesale prices the parity worked out in August 1946 to 16.69 cents. On the basis of then existing price levels, the pound itself had a parity of 4.68 in terms of wholesale prices and 5.49 in terms of cost of living index as against the pegged rate of 4.03 in force during the war. While many of the currencies were 'over valued' by the Fund, the important cases of 'under-valuation' were Canada, South Africa and Britain.

Now, there were countries like Argentina, Australia, New Zealand, Sweden and Switzerland which were not members of the Fund at that time. Exchange rates for the currency of these countries also showed a tendency to exceed parity rates. This was also the case with the member countries, for whom no exchange rates were announced at that time. This has been cited in support of fixing rates below the parity.

Not that the price level or the internal purchasing power of a currency unit necessarily tells us much, or anything at all, about the equilibrium or ideal rates of exchange. For one thing, the prices of internally traded goods have a tendency to equilibrium in any case, in the absence of crippling trade restrictions. These prices, therefore, are determined by the exchange rates and cannot determine the latter.

Then again, the prices of domestic goods which do not directly enter into international trade have little reason to move together and have little bearing on the question. What matters more in effecting a balance in a country's international payments are the terms of trade , capital move-

ments, changes in tastes and in the technique of production, movements of output and employment within the country leading to changes in demand for imports. None of these factors can be brought within the framework of the price parity. Nor do they not lend themselves readily to a formulation that may help in determining proper exchange parities.

While the initial parity rates adopted in December 1946 were thus professedly tentative, the Executive Directors of the IMF in their report for the fiscal year ended April, 1948, laid down what they considered to be the appropriate timing for an adjustment of these rates and also the variety of factors on which it should depend. The IMF, however, are not entitled to initiate a change, though they have an obligation to keep the operation of the exchange rates under constant review. In fact, their initiative in this matter appears to be strictly limited. They can suggest a change only when they feel that the par value cannot be maintained "without causing recourse to the Fund on the part of that member or others on a scale prejudicial to the Fund and to members". The difficulty about this criterion is that a number of countries, whatever exchange rates they adopt, will have a deficit in their balance of payment over the next few years, thus necessitating their making full use of their annual drawing rights on the Fund. In the case of such countries, the scale of recourse to the Fund will not be dependent upon the level of the exchange rates. Of course, the Fund might fear that if the existing rates were maintained over a period of years, these drafts upon the Fund might become chronic, but in

(Continued on page 21)

Off The Record

The Deep End

A BROTHER scribe took deep umbrage and rightly so, that the so-called experts should confuse the lay public by a parade of jargon on an issue like devaluation instead of clarifying things for them. Clarification, he felt, is possible if those who profess to know about such things are clear in their own minds, and take the trouble to express themselves in simple language. As it is, either they are concealing their ignorance under a cloud of technicalities, or else they really know what they are talking about but think it befits their dignity to clothe their knowledge in a cloak of mystery. But a cat may look at a king, and the public has a right to know what the expert finds out after delving into statistics and playing with his curves and diagrams.

What had roused his gall was the real or imagined snubbing he had received, from officials of an institution maintained at the cost of the taxpayer to throw some light on the country's currency problems, besides managing the nation's currency and credit.

This brother scribe happens to have to his credit years of reporting and news-hunting in that clearing house of world news which is London. And his profession had led him on occasions to talk to the world's foremost experts. But unlike their pigmy compeers in this country, they never tried to shut him out as he says he had been shut out by the latter. This is a serious accusation but it so happened while he was in this nasty mood he picked up an issue of the *Economic Weekly* for gaining some light of the problem of devaluation which had been perplexing him and he came upon an article in the aforesaid publication which had a title, promising some light on the subject of his enquiry. Unfortunately for him the article opened with a sentence which got his dander up. It read as follows:

> "The pound has decided to look the dollar in the face, by standing on its toe. Is it necessary for the rupee to take up the same unnatural position?"

Now English is not the mother-tongue of the author who had penned these lines. Probably what he sought to convey,—for it was the end of July,—was that Sir Stafford Cripps had put up a strong fight to avoid devaluation of sterling, for which pressure was being put on him from the other side of the Atlantic. The author of the article in question wanted to know if the case for resisting devaluation was stronger for the rupee than it was for the pound. He thought that the more gentle remedy of reduction of prices in India would adequately meet the situation and there was no need of devaluing the rupee. This particular conclusion does not concern us here. Perhaps some commiseration for the poor writer would not be out of place, if his effort at English composition, which drew such uncharitable remarks from the brother scribe afore-mentioned, had been as unsuccessful as the latter thought it to be. But there was no deliberate attempt in this case at least to obscure the issue or to make confusion worse confounded.

Anyway, Sir Stafford's valiant