Foreign Exchange

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THE NEW INTERNATIONAL CURRENCY ARRANGEMENT

The new international currency arrangement is designed to achieve as much stability in the exchange rates of the major world currencies as the basic economic situation permits. This stability is being achieved in much the same way as it was achieved under the old gold standard in ordinary times. Under the old gold standard a country's business transactions with the world were either in balance or gold moved to settle the balance. If, for instance, the United States bought more abroad than it sold to foreign countries so that there was an excess of payments due to foreign countries, gold exports from this country made up the difference. If the situation was the reverse, gold moved in. Exchange rates were kept stable by this flow of gold. Essentially the same thing is being done under the new currency arrangement, although gold movements are almost wholly in the hands of central authorities, the operations of whose Stabilization Funds are not reported. The gold in these Funds is being moved from one country to another to settle international balances and maintain exchange rates stable. Exchange rates are not being held as rigidly stable as under the old gold standard, but essentially it is the same system so long as underlying economic conditions do not get out of line.

Should underlying economic conditions get out of line with exchange rates, however, the difference between the present currency arrangement and the old gold standard would be apparent. Under the old standard the exchange rate was fixed for better or for worse. If a country's costs became too high to permit it to sell to advantage on world markets, then its only solution was to force down domestic prices and wages. There was no possibility of letting its exchange rate decline, for the gold value of its currency was rigidly fixed by law.

This is the situation in which France found itself in recent years. At the legal parity of the franc French costs of production were well above American and British costs, and merchandise exports from France declined year after year. French business was stagnant and capital moved abroad for investment and for security. To maintain the currency at its fixed gold parity, gold was shipped abroad in increasing volume. The loss of gold brought deflationary pressures to bear upon the whole French economy, but the downward adjustment of French costs was a slow, difficult, and inhumane process; and it was impossible for the country to go on exporting great amounts of gold year after year without exhausting its gold reserves. The situation called for a readjustment of French currency to bring French costs in line with world markets.

It is a readjustment of this character that the new international currency system is designed to facilitate. The new system works like the old gold standard only when economic relationships are fundamentally in balance. When a country's costs of production get radically out of line with its world markets and large and continuous sales of gold are necessary to hold exchange stable, the exchange rate of that country may, under the new currency arrangement, be permitted to decline until balance is again restored. The Stabilization Funds under such circumstances cease their support of the uneconomic rate and employ their gold only to preserve an orderly exchange market on the decline.

The exchange rate adjusts itself to the domestic development of the country instead of the domestic development being forced into the frame of an exchange rate unalterably fixed by law. Under the old gold standard the only solution of such a situation would be a grim process of reduction of domestic costs or a major currency crisis.

It is to be hoped that the new system of exchange rates brought about by gold-bloc devaluation is close enough to the true international position of the various countries of the world to enable it to last for some time. If a broad stability is achieved by the major countries in their domestic economic developments, a comparatively stable system of international exchange rates should be possible. The world now has in the form of central gold reserves resources for stabilizing exchange rates more than twice as large as it commanded in 1926. This fact, together with the greater flexibility of the present system, should result in more orderly exchange markets in the years immediately ahead than have characterized the recent period of major economic shifts and gold standard crises. If this is the case, the leading countries will, in their international transactions, enjoy the essential stability which the gold standard was designed to afford, without accepting that standard as a strait-jacket on their national existence.