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NOTES AND MEMORANDA

THE DEPRECIATION OF THE GERMAN MARK

A YEAR ago I published in this JOURNAL (December, 1918) an article on "Abnormal Deviations in International Exchanges," where I showed that one-sided interference between the trade of two countries must cause the rate of exchange to deviate from its purchasing power parity. Probably this is the most general and most important cause of a deviation from the purchasing power parity. Subsequent events have, however, shown that very marked deviations of this character may be called forth by other causes of a quite peculiar nature. In this respect the present depreciation of the German mark is very instructive.

It is difficult to give an exact measure of this depreciation. But it is so enormous that its existence cannot be doubted. The difficulty lies in the fact that nobody can tell what is at present the internal value of the mark or its purchasing power against commodities. The rise of prices has been, I think, much more irregular than, *e.g.*, in England or in Sweden. Some prices have run up very much while other prices remain at about their pre-war level; even between different parts of the country the difference in the rise of prices seems to be very great. Nor have we any reliable measure of the increase of the actual circulation within the country. German estimates put this increase at about 350 as against 100 before the war. As the country suffers from a severe shortage of commodities, the corresponding rise of prices should be estimated at something like 400 or 450. But these estimates are probably too low.

For the present purpose it is only necessary to find an upper limit for the probable inflation of the German mark. I think this limit may be put at, say, 600, as against 100 as pre-war standard. The mark should, then, have at present only a sixth of its former purchasing power against commodities within the country. A lower estimation seems hardly admissible.

The purchasing power must now be compared with that of another currency, say, *e.g.*, the Swedish crown. The Swedish inflation is probably at present represented very nearly by my figure for the relative increase of the circulation. This figure is,

for September, 307. Thus the German inflation should not be quite double the Swedish. If we take it at exactly double, the purchasing power parity between the countries should be half the pre-war parity, *i.e.*, about 45 Swedish crowns for 100 marks. Of course, this estimation is very approximative.

The present rate of exchange between the countries is, however, only about 15 Swedish crowns for 100 marks, and stands, therefore, at about a third of the purchasing power parity. Thus, with all allowance for the uncertainty of our estimation of the purchasing power parity, an enormous undervaluation of the mark as compared with the Swedish crown must be taken as established. The undervaluation of the mark in other currencies is not quite so great, so that the Swedish crown is generally overvalued in them.

That an undervaluation of a currency to this extent can take place is perhaps the most astonishing fact that war economics have hitherto brought forward. And it is of the greatest importance, theoretically as well as practically, that the causes of this phenomenon should be made quite clear. I think that in the German case some main causes can already be discerned with sufficient distinctness.

The first is the realisation of German marks at any price in order to get hold of foreign purchasing power and thus to be able to pay for necessary imports to Germany. Under ordinary circumstances an adverse balance of trade does not depress the exchange-value of a currency below its purchasing power parity. For the balance is paid, and must be paid, day by day by credits secured abroad. But when no such credits can be had, or cannot be had to a sufficient extent, and when, nevertheless, an import of necessities is indispensable, the country can try to procure the foreign money which it needs by a sale of its own currency to speculators abroad who buy it in the hope of making a gain when the exchange is restored to a more normal level. Such sales are obviously possible only when substantial concessions are made in regard to price, and must therefore always have a very destructive influence on the exchanges of the country.

It seems fairly certain that Germany has been driven by the present circumstances to such sales on a considerable scale, and that local bodies, as well as the Central Government itself, have been among those who have demanded foreign money at almost any price.

With foreign exchanges many times as high as would correspond to the internal level of prices, import should generally be

impossible as a private business proposition. But a public body may even under such circumstances find itself obliged to buy certain necessities abroad, paying for them by any amount of its own currency, but selling them at home at the prevailing internal prices. By such measures a Government can clearly depress the exchange value of its currency more and more below the parity which corresponds to the purchasing power of this currency on the home market.

Of course, if the currency sold abroad reverts to the country and makes itself felt as actual purchasing power on the home market, a rise of the general level of prices is unavoidable. At the same time such a possibility of making profitable use of the currency would enhance its exchange value. Both these movements would tend to bring the exchanges nearer to their purchasing power parities, which will, therefore, always denote the real equilibrium. But if the price of the currency abroad is very low, the currency is probably held chiefly by speculators who look for a substantial rise in its price, and therefore hold their stocks of the currency. It is also possible that the country prevents such of its currency as is held abroad from being used as purchasing power on the home market, either by export prohibitions or by measures tending to enhance the prices of commodities for foreign buyers. All these factors are, in the case of Germany, actually operating against a natural adjustment between the internal purchasing power of the currency and its exchange value.

Another, perhaps still more important, cause of the abnormal depression of the German exchanges is the export of capital which has been called forth by the extraordinary taxation of capital planned by the Federal Government. The flight of capital seems to a great extent to have taken the form of an export of German bank-notes. It is time that this export was prohibited, but as Germany cannot control effectively her western frontier, a very considerable export of bank-notes is going on. These notes are sold on foreign markets, and such sales contribute no doubt very considerably to the unnatural depression of the German exchanges. Indeed, nobody can wonder that the exchanges of a country are driven below the purchasing power parity if the fear of confiscatory taxation works as a motive for selling out the currency of the country at any price. Perhaps the experience of Germany in this matter may serve as a lesson to other nations.

It is known that Belgium and France possess very big amounts of German bank-notes, probably together about ten milliards. The realisation of such sums is, of course, quite out

of question, as it would press down the international value of the mark to almost nothing. Some sort of agreement must therefore be made by which the notes will be exchanged against long-time credits in one form or other. In the meantime the existence of these big stocks of bank-notes may be supposed to exert a certain depressing influence on the German exchanges.

For the recovery of the German exchanges, as well as of German finances generally, it is obviously of some importance that Germany should avoid all imports of luxuries. The payment of indemnity involves the reduction of the consumption of the people for many years to the barest necessities. Imports of unnecessary goods should therefore either be prohibited or reduced to a minimum by heavy custom duties. The fact that the German Government has no effective control over the western frontier makes a sufficiently restrictive fiscal policy impossible. It seems to be an economic paradox that the same countries which claim a huge indemnity should be anxious to provide the German people with the greatest possible amount of their luxuries. The present import of unnecessary articles over the western German frontier is without doubt a factor of considerable influence in the continual depression of the German currency on foreign markets and, of course, also a factor which weakens the paying capacity of the country.

The effects of the extraordinarily low valuation of the German mark abroad deserve to be noticed. Every depression of the exchanges of a country beneath the purchasing power parities means a bonus for the export of the country and at the same time a hindrance to its imports. Both these effects are felt by traders of other countries as a great annoyance. The export bounties given by an overvaluation of foreign currencies over their purchasing power parities make far wider opportunities for dumping than any measures which a direct dumping policy could invent. The neighbours of Germany will probably, in the very near future, have ample opportunity to study this effect of the unnatural situation of the exchanges. At the same time trades which have been working for export to Germany will gain experience of the almost insurmountable difficulties caused by the depression of the mark beneath its purchasing power parity.

It is often believed that the export bonus at least should be an advantage for the country itself. But Germany probably feels that she gets too little in foreign money for what she has to sell, and therefore tries to force foreigners to pay additional prices for what they buy. Theoretically such a policy might be condemned,

as it clearly tends to depress the exchange value of the mark still more. If other countries could buy freely on the German market at the present prices, the exchange value of the mark would, as stated above, increase rapidly. Such a policy is, however, hardly possible for Germany for the time being. Besides, Germany has not sufficient to sell. In some essential commodities she is so short that she must prohibit every export; for with the present abnormal exchanges it would pay to export almost everything, even food, from Germany.

A peculiar effect of the low exchange value of the German money is that foreigners are beginning to buy up industrial shares on German bourses, and that therefore the prices of such shares are rising rapidly. Again, in Sweden, whose currency is perhaps the most overvalued of all, the share market suffers from a quite exceptional depression. It seems worth while to study the connection between these movements somewhat more closely.

It is, without doubt, in the interests of the whole world that abnormal deviations of the rates of exchanges should be avoided and that the exchanges, as soon as possible, should be brought into accordance with the internal values of the different currencies. It is vain to hope for an economic reconstruction of the world so long as the present confusion in the world's monetary conditions is continued. All countries must unite their best efforts in order to put the world's monetary affairs on a sound base. For this purpose it is essential that the exchanges should be normal, that is to say, that they should coincide with the purchasing power parities. In the case of Germany this end cannot be attained without the collaboration of the Powers who control her finance, and specially her western frontier. But these Powers also have the greatest material interest in a recovery of German exchange.

The deviation from the purchasing power parity is especially great in respect of the mark. The present situation of the German currency, therefore, affords the best opportunity for a study of the causes and effects of such deviations. Probably we can learn from this case much that is applicable in other cases where the deviations of the exchanges from their purchasing power parities are much less and their effects consequently not so clear. In this way we may perhaps hope to get a deeper insight in one of the most intricate, most actual, and practically most important chapters of economic science.

G. CASSEL

Djursholm, Sweden, October, 1919.