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Economics Newsletter

Economics Department

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DEVALUATION AND SOME OF ITS EFFECTS

Money and Its Uses. Basically, money is anything that acts as a medium of exchange. A medium of exchange is something that may not have any intrinsic value of its own but is readily accepted by others in exchange for goods and services. This eliminates the necessity for direct bartering for desired items.

Money also has some other uses. It is a means of storing value for later use and it is a means of investment in foreign productive facilities. Each of these uses will be discussed here in an over-simplified analysis.

Devaluation. Looking at it from an individual's point of view, if his dollar will no longer buy what it used to, the value of the dollar is deflated, or devalued, to him. If he has held it for a long period of time as a store of value but finds that it will purchase only half of what he was expecting to buy with it, then the deflated value is of increasing concern. Persons on fixed incomes, such as retired people living on incomes valued in dollars at some time in the past, have traditionally found that over a period of years this does, in fact, happen.

International Trade. What has been said above applies as well to international dealings. Much of international trade is on more than a bilateral basis. Country A may sell bananas to Country B; Country B sells olives to Country C, and so on. The need arises

then for some way for the countries to settle their debts other than by barter. An international money that they can all value in terms of their own money is essential. And the businessman and others doing the trading like to have these relationships reasonably stable.

Until very recent years, the United States has been a net exporting country, meaning that we exported more than we imported each year and thus other countries owed us money. However, in recent years through our military installations around the world, tourists travelling abroad, foreign investments, and purchases of goods for use in the United States, we have become a net importing nation. This means that we owe other countries more than they owe us. One way of helping to correct the situation is through devaluation of the dollar (at the other countries' expense); another is an upward valuation of other currencies, with the same net result.

Devaluation of a Currency. Most countries do not like to devalue their money because of the onus given it as a creditor nation, much as a person going through bankruptcy receives a blot on his credit rating. Devaluation, then, is normally a last-ditch stand to try to bring about some changes in foreign trade patterns.

The effects of devaluing (assuming that the other countries do not retaliate in some way) result in tightening up on imports which derives from a decline in

demand because of the relatively higher prices our buyers will have to pay. It is expected to expand exports because the costs of our goods will be less to the foreign countries.

An older, but rather clear-cut example may be given. In 1967, England reduced the value of its pound from \$2.80 to \$2.40. A British-made car that would have cost \$2,800 before the devaluation, could later be purchased for \$2,400. This is about a 14.3 percent reduction in cost and tended to encourage imports into the U.S. Conversely, a British farmer that had been buying corn, at say, \$1 per bushel, later had to pay \$1.17 a bushel. This rise in price has an impact on the demand for the corn.

In South Dakota, corn prices follow the national trend. Thus, if the British do not buy as much corn because of the

higher price, corn stocks will be higher and the prices of corn will tend to drop. Importing more from Britain at their lower prices may help other segments of our economy, such as manufacturers of machinery that import a lot of steel. Prices will tend to fall and perhaps the farmer will gain in lower prices for farm machinery. A devaluation of the dollar is intended to act in reverse.

U. S. Devaluation. The United States has devalued in attempts to partially correct its balance of payments problems and most recently some other countries have let their currencies float against the dollar, meaning that they are being allowed to find their own level of value. However, other countries are responding in various fashions. Whatever the outcome, the real value of any money or medium of exchange that evolves is what it will buy in goods and services and this varies over time.

Robert J. Antonides, Extension Economist

REMINDER: Agri-Business Day is next Wednesday, April 4. Registration 8 to 9 a.m. at the Elks Lodge, 516 Fourth Street in Brookings.

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