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Once More: The Pound Devaluation

The improvement of the balance of payments by £500 million, the increase of production by 4 to 5 per cent and the reduction of unemployment to 1.7 or 1.8 per cent, respectively, till the end of this year are the targets set forth by the British Government in connection with the sterling devaluation of November, 1967. For weeks already it is one of the commonplaces of economic policy discussions that the realisation of these ends is to a decisive extent depending on the success of the simultaneously introduced restrictive policy. That, however, the realisation of the above mentioned aims is quite considerably influenced also by the national economic policy of other industrial nations is an aspect which found but little attention as yet.

Although the British Government succeeded in fixing the devaluation rate at 14.3 per cent in such a manner that a general devaluation race did not come about, it was evident from the first that the net rate of devaluation would amount to between 8 and 10 per cent at best. There is, however, the risk that this rate will decline even more. As it has to be anticipated that the devaluation will lead to an advance in the cost of living, wage increases are not improbable in British industry. Should the trade unions succeed in obtaining wage rate increases exceeding the progress in productivity, then the net rate of devaluation would decline once more. The same applies even more if the Government is not able to stabilise the general price standard on the level reached after the absorption of the price increases as affected by the devaluation.

It is, however, mostly forgotten that the devaluation does not only influence the development of costs and prices in Britain but also in the rest of the world. Supposing, for instance that in 1968 price increases in the Federal Republic of Germany will be lower owing to the devaluation of sterling than they would have been otherwise, in the last analysis this means that it also contributes to diminish the devaluation net effect.

The connection between the success of the sterling devaluation in Britain and the economic development abroad becomes even more distinct if we occupy ourselves with estimates of the price elasticity of foreign demand for British export goods. Dealing with the forecast of exports one usually starts from a given export projection, which does not take the devaluation of sterling into consideration. But regarding the determination of price elasticity it cannot be assumed that apart from the changes of prices and quantities—represented explicitly in each case—no other data changes will occur.

Much boldness is required if under such conditions one engages in an estimate of the British export increase as conditioned by devaluation. First the price elasticity of foreign demand for British export products is not independent of the importing countries' economic situation which is possibly influenced by the devaluation. Secondly, this figure is also determined by the export drive in Britain's most important competitor countries that may also be intensified by the sterling devaluation. If the Federal Republic is taken as an example, which, on the one hand, is a quite important sales market for Britain and, on the other, one of the main competitors on the world market, this means that the price elasticity of foreign demand for British export goods must be assessed differently. It depends on whether the contractive effect on the German economy resulting from the sterling devaluation will cut its way through to the economic trend or will be compensated by economic policy measures. But as a well founded forecast of the West German economy's development particularly in the second half of 1968 does not seem possible at present, any assumption concerning the price elasticity of foreign demand for British export goods is subject to additional uncertainties.

Certainly, the influence of economic development abroad on the devaluation effect should not be overrated. It would, however, be also wrong to neglect this influence completely. If in recent months international economic responsibility was so much talked of, it obviously must not be limited to a generous provision of foreign loans. The national economic policy of other world trade countries has a considerable influence on the success of the devaluation.

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