COMMONWEALTH OF AUSTRALIA

SPEECH

BY

The Rt Hon. W. McMAHON, M.P.

ON

INTERNATIONAL CURRENCY

Ministerial Statement

[From the 'Parliamentary Debates', 26 August 1971]

Mr McMAHON (Lowe — Prime Minister) — The right honourable member for Melbourne (Mr Calwell) has asked that I make a statement on the measures for the protection of the United States dollar announced by President Nixon on 15th August. As honourable members will be aware, the situation in the international currency markets is changing from day to day and any assessment of the situation has to be treated cautiously at this point of time. However, in the view of the importance of the developments I feel it desirable to give the House a preliminary assessment. As honourable members will know, the present disturbed situation in the international currency markets was sparked off by the announcement of the President of the United States last week that convertibility of United States dollars into gold and other reserve assets was to be suspended, and a 10 per cent surcharge on all dutiable imports into the United States, other than those subject to quotas, was to be imposed. Both these decisions were announced by the President to be temporary. But it was made clear that the removal of the 10 per cent surcharge, and the resumption of convertibility of United States dollar balances, would be dependent on certain objectives being achieved by the United States as a result of negotiation in the fields of international trade and finance and the sharing of defence burdens.

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As to trade, the President claimed that American products were at a disadvantage because of unfair exchange rates. He said that the import tax would be ended when the unfair treatment ended. In the field of finance, the President asserted the need for a widespread major realignment of exchange parities, and also for an improved system of international monetary arrangements generally. The President also said that the time had come for other economically strong nations to bear their fair share of defending freedom around the world. This latest disturbance on the international currency markets is only the most recent of a long succession of similar disturbances, centring on one major currency after another, and sometimes on groups of currencies. In 1967 we had the disturbances leading up to the devaluation of sterling. In 1969, the pressure was transferred from London to Paris and we had the devaluation of the French franc and the revaluation of the Deutschemark. More recently, the trouble has centred on the United States and has been attributable in large part to the growing balance of payments deficit of that country. This has led to a fall in United States official reserves and a sharp increase in its official short-term liabilities. At the same time, there has been a substantial transfer of United States dollars on private account into the international monetary markets of the world.

All this has served to weaken confidence in the United States dollar on the foreign exchanges.

A number of factors has contributed to the United States' external deficit. Prominent among these is the rapid price and cost inflation in the United States over the last 5 years. The United States' position has been exacerbated by the growing competitiveness of some of its trading partners and by restraints on the access of United States' exports to markets abroad. Superimposed on this has been the heavy defence burdens of the United States. Defence expenditure abroad by the United States has recently been running at the level of about $US5 billion annually. One way and another, the balance of payments deficit has built up until, in the first half of this year, the deficit has been running at an annual rate of $US23 billion.

It is not surprising, in these circumstances, that the United States dollar is now commonly regarded as being 'over valued'. In other words, the existing exchange parity for the United States dollar overrates its international purchasing power. This, of course, is a matter of critical worldwide importance because of the pivotal position in the international monetary system of the United States dollar.

The United States dollar is the largest of the reserve currencies in the world today and many countries have fixed rates of exchange on the dollar. A great proportion of international trade and financial transactions has been settled through the dollar in the past. And the dollar has been adopted, along with gold as one of the two basic units of value in the Bretton Woods monetary system. Other currencies have had their par values expressed in terms of the United States dollar and gold.

There is no doubt that the Bretton Woods system has made a major contribution to full employment, economic growth, and the orderly development of world trade and financial arrangements in the post-war period. It has achieved this as a result of the adoption of a number of working principles, not least of which has been the system of agreed parities of rates of exchange between participating countries, adjustable only with the consent of the International Monetary Fund in the case of fundamental balance of payments disequilibrium. This system of pegged parities has been of particular value to smaller countries as a protection against the pre-war practice of currency manipulation and competitive depreciations. It has also been of value to rapidly developing countries like Australia who do not have access to the economic dialogues centred on the United States and Europe.

Nevertheless, no system is proof against the ravages of time and the Bretton Woods system is no exception. The need for further development of the Bretton Woods arrangements has long been recognised, and the most recent innovation has been the establishment of special drawing rights which, in themselves, offer some alternative to the United States dollar and gold as an international reserve asset.

Another innovation, and this is very germane to the present situation, is that the Executive Board of the Fund has been discussing the case for a greater flexibility in the mechanism of exchange rate adjustments. There is a strong body of opinion which suggests that the present arrangements whereby exchange rates should not vary more than 1 per cent from parity should be changed by extending somewhat the operating limits within which currencies could be exchanged without being held to infringe their par values at the International Monetary Fund.

The action taken by the United States last week has short-circuited this debate and take the question of exchange rate adjustments into the field of immediate practical necessity in the foreign exchange markets. The 10 per cent surcharge on dutiable imports would, were it to be continued, strike heavily at the exports of countries like Japan which have had a large and growing market in the United States for goods of the kinds subject to the surcharge. Through the effect of this on industries in such centres it would in turn tend to reduce their demand for materials supplied by other countries in the normal course of events. The surcharge is currently under consideration in the General Agreement on Tariffs and Trade.

The United States has, however, said that it sees this trade action as a means of securing revaluation of the currencies of countries which it considers to have an unwarranted advantage over it in point of trade competition because of their existing parities. If and to the extent that other countries were to revalue their currencies, the United States dollar would be devalued in relation to them. The United States Government has chosen this approach to its problem in preference to seeking a formal devaluation of its currency against all other currencies.

Amongst other things that course would involve the United States in altering the value of the dollar in terms of gold. The President has said that his Government does not intend to alter the present dollar price of gold. We have, as yet, no real idea as to what the final response of other major countries to the United States initiative is going to be.

Under the rules of the International Monetary Fund, the exchange parity of any country which is a member of the fund can be altered only if the country itself seeks a change. It seems reasonable to suppose that few, if any, major countries are likely to seek such a change unless and until other countries take steps to do so. As yet there is no firm indication of concerted action amongst major countries to that end.

On Thursday of last week the Finance Ministers of the European Economic Community, meeting in Brussels, failed to reach agreement on any form of common action in the matter. The foreign exchange markets in Europe were closed last week but have re-opened this week. There have been no formal revaluations on the dollar but the majority of European countries have allowed their buying rates for dollars to exceed the Monetary Fund limits of 1 per cent beyond parity with the dollar. In point of fact, however, the markets so far this week have been fairly steady on the dollar and the dollar has fallen in value in most markets by something in the region of only 2 per cent to 3 per cent below the rates ruling before the markets closed.

I want to stress that this is likely to be an interim situation since it has done nothing to achieve the more significant realignment of exchange rates which the United States, and the Managing Director of the International Monetary Fund, consider to be necessary. This fact must be borne in mind in all our thinking and calculations. If, of course, a number of major currencies were to seek and obtain adjustments of their exchange parities under the International Monetary Agreement a question could arise as to whether Australia should seek some such adjustment. If such a situation were to arise, we would need to make the most careful assessment of it from the standpoint of our own interests both international and domestic. But no such situation has arisen yet.

We are keeping closely in touch with developments and studying all possibilities. At the same time we are preserving for ourselves the greatest possible scope for independence of action. If it should come to a decision whether or not to seek some alteration of our exchange parity there will be only one proper basis for decision—the interests of the Australian economy and the Australian nation as a whole. Meanwhile, in the state of uncertainty which must prevail until the large issues I have mentioned are crystallised and intentions on the part of major countries become clearer, foreign exchange markets are likely to be very unsettled and changeable. We may also see large movements of funds between financial centres. It will be a matter of adjusting our own exchange dealing arrangements to meet changing situations as they arise.

In this state of uncertainty in the foreign exchange markets it is not possible to settle on a firm exchange rate for the Australian dollar. However, in order to enable overseas transactions to be resumed, it has been decided to continue to fix an exchange rate with the pound sterling on a daily basis. For purposes of the last 3 days trading the existing parity with sterling—that is, $A2.1429 for £1 sterling—has been maintained. It is true that, as sterling has been traded at a rate about 2 per cent above parity with the United States dollar, this means that at the moment there is, in effect, a similar small appreciation of the Australian dollar in relation to the United States dollar. However, the situation is being reviewed on a day-to-day basis and any short term change in the rate should not, of course, necessarily be taken as an indication as to the long term rate that will eventually be settled for the Australian dollar.

For the time being, and until further notice, banks have been advised that they may undertake foreign exchange transactions in respect of normal trade transactions, other current account payments contractually due, and the reasonable requirements of travellers. Rates of exchange for these transactions are quoted by the banks under arrangements with the Reserve Bank and are based on developments in the London and other main foreign exchange markets overseas.

The Reserve Bank is not yet offering facilities to the banks to cover them for forward transactions and, of course, this limits the scope of banks to offer such cover to their customers. I think this is reasonable in view of the present unsettled circumstances on the foreign exchanges. We will be ready to adjust our position as required in accordance with the emerging situation.

I present the following paper:

International Currency—Ministerial Statement, 26 August 1971.

Motion (by **Mr Swartz**) proposed:

That the House take note of the paper.

W. G. Murray, Government Printer, Canberra