ADJUSTMENT OF CURRENCY CONVERTIBILITY

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Abstract

Although it is a very important economic issue, the currency convertibility has become one of the most neglected issues in the modern economic theory, particularly after the abolition of dollar convertibility into gold in 1971. Nowadays, it is said that the currency convertibility is a technique for exchange of one currency to other currencies at floating rates in the cross rates of exchange in the world and it is treated as a consequent solution into the evolution of currency convertibility. However, the facts are contrary to the treatment of such a kind. The exchange of one currency to other currencies at floating rates is a digression in the evolution of currency convertibility because its effects upon the rationality of the process of international division of labour have been corrected by this type of convertibility. This is a priority function within the original meaning of currency convertibility. However, this function cannot be fulfilled effectively without creating a global currency by which the national currencies will be connected to fixed, but adjustable exchange rates.

Key words: currency convertibility, dematerialization of money, system of gold standard, fixed rates, floating rates, global currency

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INTRODUCTION

Historically viewed, the currency convertibility is a key institute of the national monetary systems and the International Monetary System (IMS) because it makes it possible for money to perform its functions maximally and effectively in the national economies and global economy, creating conditions for unhindered economic development on the basis of the principle of rational international division of labour. The need for establishing currency convertibility has imposed itself because of the development of the objective process of dematerialization of money. Within this context, we will follow up the original meaning of currency convertibility in the system of gold specie standard and its role in improving the payments in the national economies and the international payments as a basis for more intensive development of the international economic relations.

The rise in sales in separate countries and between them and the absence of an adequate growth in the production of gold forced the development of new types of currency convertibility. The convertibility into gold bullion (gold bullion standard) and convertibility into currencies exchangeable for gold (gold exchange standard) being used in combination, were a logic consequence of the development of the process of dematerialization of money within the framework of the national borders of separate countries and of the direct need for providing convertibility of the national currencies into gold for the needs of international payments. The reasons why they lasted briefly are not in their position, in the mechanism of their functioning, but, above all, in the change of the social-economic goals of the development of separate countries, particularly after the Great World Depression when it has been assumed the internal balance to be over the external one and the interventionism over the liberalism in the relations abroad.

In the evolution of currency convertibility, an important place takes the type of convertibility known as gold exchange standard determined in the Statute of IMF. It has been a reflection of the needs of time and the relations between the forces during and after World War II. It maintains the connection with gold and at the same time there is provided convertibility of currencies being exchangeable for gold. Within this context, a special place takes the unilateral decision of the U.S. Treasury on purchasing dollars at a price of 35 dollars for one ounce of pure gold. This decision has made easier the change-over from gold exchange standard to gold-dollar exchange standard, and after the elimination of gold from IMF, also to dollar standard while the currency convertibility has profiled itself as an exchange of one currency to other currencies at floating rates.

Despite making easier the process of dematerialization of money in the national economies and global economy, the currency convertibility has in its original meaning the promotion of multilateralism as a condition for rational international division of labour, being in interest of every country and the world economy on the whole, which is contrary to bilateralism. In order to achieve the already mentioned goal in the Statute of IMF, it has been determined a proposition for establishing external convertibility of national currencies as a minimum level of multilateralism. However, the higher level is assuming liberalization not only of the current but also of the capital transactions.

By abandoning the convertibility of dollar into gold and by changing over the floating rates in the cross rates of exchange in the world, it can be said from the aspect of the original meaning of convertibility that it has been registered forced validity of the national currencies used freely within the international payments. In spite of the obligation to repay a certain quantity of gold or a certain amount of currencies being convertible into gold, the creditors have to satisfy themselves in the international exchange with the payment by certain national currencies which can be easily exchanged for other currencies, but are prone to a change of their value and are largely dependent upon the national interests and policies of the countries with such currencies. The practice sanctioned several national currencies to perform also a role of world money.

The problems out of digression in the evolution of currency convertibility have resulted in the biggest global crisis after the Great Depression in the 1930s. The developed countries, whose currencies perform functions of world money, hidden behind the possibility for exchanging their currencies for other currencies at floating rates, irrespective of the reasons, led a relaxed monetary and fiscal policy which ended up in bubbles of the real and financial assets. In addition, the developed countries did not upset themselves as a result of that because they are carrying part of their problems in the countries which make the international payments by their own currencies and they have been brought in such a situation because there is not and there is no desire to be brought in a global currency. In its absence, the less developed are condemned to suffer the consequences of the maladministration of the elites in the developed countries and to hope that the demands they are going to meet with their help, will not lose much of their value. However, the hopes are getting more and more minor because the way for mitigating the contradictions between the labour and capital and the means for stimulating the economic growth and employment are found into the manipulation of the value of national currencies.

The original meaning and evolution of currency convertibility

The currency convertibility occurs in relation to the development of money in the process of their dematerialization, and this means that it follows and affects the changes of the types of money, guaranteeing that the money without a material substance (paper and giro money) represents the monetary goods – the gold.

The nuclei of currency convertibility can be looked for within the process of dematerialization of money which has begun with the London goldsmiths' practice of issuing the individuals who deposited their ready money (gold coins) at the goldsmith's with notes of receipt which gave the holders the right to withdraw the deposited amount of money from the goldsmith whenever they wanted. Conditioned by the credibility that the goldsmiths enjoyed, the given right was sufficient enough for the certifications i.e. the notes of receipt to start circulating in the turnover instead of the deposited legal tender. Those certificates are not money, but they serve as money (they are a monetary surrogate). By initiating them in the pertinent monetary system, there are not any crucial changes. The circulation does not increase because if the certificates do not circulate, then the gold or silver coins will circulate instead. The initiation of certificates presents only "*technical improvement of the circulation of metal money*"[3]. The problems in relation to the need for minting coins of larger amounts and their unwieldiness were solved by them and thus, there were reduced the costs and dangers upon the transport of larger amounts of coins.

The need of convertibility, in an economic sense, occurred when the goldsmiths on the basis of their experience – certificates were more often received than coins and they were more seldom returned for repayment of the deposited money – started to issue certificates despite the deposited total amount of coins. Very soon, only the banks began to

[3] Dr Vjekoslav Majhsner: The Basic Sciences of Money, University - Skopje, 1958, page no.48.

deal with this type of work and because of that the money was named bank notes. Therefore, the text on the certificates could not read any more as follows: "I received in deposit 10 pounds of coined gold which I am going to repay at the request of the bearer of this certificate" because it did not respond to the real state of affairs, but only like this: "I will pay 10 pounds in coined gold at the request of the bearer of this slip of paper" [4].

The obligation is obviously the same, but the difference is the fact that the guarantee in the first situation is 100 per cent whereas in the second situation, it is opened the possibility that the issuer cannot pay off the appropriate amount of gold without delay and at the same time at the request of the owners of the bank notes. However, the obligation for exchange (convertibility) of bank notes for coins has undoubtedly provided their more intensive use in the turnover. The registered legal obligation to receive them as a means of payment only sanctions the permanent practice.

That the interchangeability was only a technical question results from the fact that the certificates had 100 per cent legal currency coverage (gold and/or silver). However, the obligation to exchange the monetary surrogates (the certificates and bank notes) for legal currency, under conditions when their 100 per cent coverage started to reduce, gets a remarkable role in the unhindered development of the process of dematerialization of money prompted by the discrepancy between the rapid growth of commodity trading and the slow growth of gold as monetary commodity. The convertibility made possible the potential tendency towards deflation to be outweighed by issuing bank notes to the amount of gold money that the turnover should have, but there was opened the possibility for inflation as long as the amount of issued bank notes outweighed that ratio.

The positive practice of their interchangeability made possible the further development of the process of dematerialization of money by the larger increase in the incomplete coverage of bank notes in monetary metals up to the abolition of convertibility of bank notes into gold money and their convertibility into paper money at a legal rate. Thus, the money has become independent of whatever natural restrictions in relation to its creation. However, it has not changed its essence. The essence of money does not change

[4] Ibid., page no.49.

even when it gets the form of giro money. It also represents the gold. Its ratio towards gold is a ratio of representation.

The original meaning of convertibility turns us towards the historical moment when the gold as commodity transformed itself into money. This happened because the gold gave the commodity world a material for expressing the values, presenting them as eponymous dimensions being qualitatively equal and quantitatively comparable. Thus, this functions as a general measure of value and as a result of this function, the specific equivalent commodity i.e. the gold becomes money. Therefore, it can be said that out of the convertibility of real money (gold) into commodity rises, in fact, the need for convertibility of monetary surrogates into gold as an absolutely convertible commodity.

The essence of currency convertibility of the system of gold specie standard is maintained even when it comes down to gold bullion standard and gold exchange standard. In the gold bullion standard, the convertibility of currencies is limited to the possibility for exchange of larger amounts of gold (gold bullion) whereas in the gold exchange standard, it is a matter of exchange of currencies being convertible into gold. Both these currencies and the gold served as a basis for emission of money in the country that kept them as a monetary reserve and as a form of demands in the foreign banks. In all these types of currency convertibility, the national currencies have a fixed gold parity (a fixed amount of gold) whereas the exchange rate towards the other currencies is determined through the ratio of the gold parities of two currencies.

The Great Depression of the 1930s and World War I put an end to the hopes for the establishment of the changed but, yet, gold standard whereas the world relied itself on the measures of the arsenal of interventionism to regulate the internal flows and economic relations abroad.

After World War II the currency convertibility was an organized answer of the international community for outweighing the thorough currency and economic bilateralism of the economic relations in separate countries with the purpose to multilateralize them in the interest of every country separately and in the interest of the world economy on the whole. The knowledge about the advantages of multilateralism was indisputable, but the problem was that such a mechanism in the face of the system of gold standard was abandoned during the Great Depression and there was established currency interventionism which has crystallized itself, in the process of time, into an instrument of general maintenance of full employment as a new principle of economic policy.

The way out of currency interventionism was tracked down in the founding of the International Monetary Fund and the World Bank as institutions which will take care of the world liquidity and of providing the less developed with an additional support as a compensation for the liberalization of their relations abroad and of putting an effort into their multilateralism as part of the total efforts of multilateralism of the monetary and economic relations of the world. With the implementation of such a concept, it was wanted to diminish the interests in bilateralism in the economic relations and to prompt the efforts for liberalization and multilateralism, at least for current transactions (external convertibility of the national currencies).

In the concept of the Fund, the convertibility is based on the conversion of currencies into gold and into currencies being convertible into gold; on the fixed exchange rates which may change only to 10% without the approval of the Fund and on the support of the Fund for overcoming the problems of short-term balance of payments in the member countries. The World Bank had to help the member countries provide long-term means for development. Under such conditions, the obligation of the member country which insisted on establishing the convertibility of national currency, was to liberalize gradually the economic relations with the foreign countries, but once it assumes the obligations of Article VIII, it has to provide conversion of the non-residents' demands, arisen on the basis of current transactions, into its own currency and not to impose new external trade and exchange restrictions i.e. to liberalize further on the relations with the foreign countries.

It is a matter of the concept of external convertibility and current payments. However, it should be taken into account that this concept undergoes corrections in practice. Even at the beginning, with the unilateral decision of the USA to buy dollars earned by non-residents at a fixed price of 35 dollars per ounce, it has been intervened in favour of the functioning of dollar as world money, in addition to the gold. It was everything all right until the earned dollars of the applicants were converted into gold. However, the policy of such a kind could not last long. Nevertheless, it is a fact that the Americans forced the rest of the world to observe the dollar as gold although it proved soon that it is not like that. This was approved by the decision of creating Special Drawing Rights of the so-called "paper gold" through which the national currencies determined their values.

The biggest change of the concept of convertibility in IMF has occurred with the abolition of the convertibility of dollar into gold and with the elimination of gold from the International Monetary Fund and at the same time by abandoning the fixed and changing over to floating rates in the cross rates of exchange in the world. This change has an effect of establishing forced validity of the national currencies used freely in the international payment transactions, first on the dollar and later on the other hard currencies. Instead of going along the way of developing the Special Drawing Rights, several countries' national currencies functioning as world money have imposed themselves on the world as "paper gold" and they have boiled the currency convertibility down to exchange of one currency to other currencies at floating rates. This is in essential opposition with the importance of gold parities in the system of gold standard and with the fixed but adjustable rates of exchange in the Bretton Woods system (up to the abolition of convertibility of dollar into gold).

It has also come to a further degradation of the currency convertibility due to the forced practice of IMF of accepting formally the obligations of Article VIII (external convertibility) from countries which were not objectively qualified to assume such an obligation. In practice, the external convertibility has realized itself as internal convertibility of home currency (exchange of the home currency to other convertible currencies in the country). Thus, the efforts for multilateralism of the national currencies have reduced to acquisition of hard currencies by providing a status of external currency convertibility in order to fulfill the obligations towards abroad. It is absent the economic necessity of rational incorporation in the international division of labour being imposed by the status of external convertibility as a result of the obligation to convert the demands of the foreigners on the basis of current transactions into currencies for mass use. The volume of their exchange boils down to the amount of the acquired currencies, and is not in the interest of the foreign exporters. Therefore, there are few countries, with allegedly external, but factually internal convertibility of their currencies, which pay the import with national currencies. Thus, the efforts for direct multilateralism of their national currencies have been reduced because they pay with currencies used freely and their efforts are directed towards the acquisition of such currencies. Therefore, their value is very variable and it cannot be treated as solid information for allocation of the investments and for marketing of the production and services.

The currency convertibility through promotion of multilateralism

By reducing the level of coverage of paper money and their convertibility into gold, the process of dematerialization of money in the national economies ended up in building monetary systems which do not cross the borders of separate countries. Despite the home implications, the system of gold standard had "greater importance in the international monetary relations. The stabilization of the currency exchange rates was probably one of the most significant moments of gold standard and the main reason that it spread so and it still has a great reputation for considerable number of theoreticians and even more practitioners"[5]. The quotation is said long time ago, but it is relevant and nowadays, considering the mutual accusations of separate countries of depreciation and overvaluation of the rates of national currencies and the warnings of danger of currency wars.

The functioning of the system of gold standard has undoubtedly provided dynamic changes in the balance of economic forces of separate capitalist countries in favour of those which were producing more productively. The purpose of the international gold standard was to stabilize the international ratio of value of separate currencies if possible by tying up every separate value to the same standard of values and thus to make easier not only the international payment transactions but also the international trade and the international capital movement at high liberalization in the progress of the factors of production. In conditions like these, there was present the tendency towards optimal utilization of the factors of production on the basis of the international division of labour.

It was the same and the purpose of the Bretton Woods system (up to the demonetization of gold from the international monetary system), but it had a reduced influence as a result of the emphasis on promoting the current transactions in the international economic relations. In such a context, it is particularly important the fact that the stability of rates is regarded as a base of the settled international relations and once the

[5] Dr Vjekoslav Majhsner: Money in the Development of Human Thoughts, Yearbook of the Faculty of Economics - Skopje 1959, page no. 171.

parity of the member country was determined it could change itself only to correct "the fundamental disequilibrium" in its balance of payment.

The stable rates of exchange forced efforts out of all countries i.e. of their manufacturers in order to increase the productivity and business efficiency, to provide competitiveness at the world market whereas the possibility for depreciation of the value of national currencies was a safety-valve for mitigation of the internal contradictions of all countries.

The effects of currency convertibility have been reducing by strengthening the protectionism in the international exchange and by changing over the floating rates to cross rates of exchange, as a result of the possibilities for dropping part of their own burden in other countries, by taking various protectionist measures, by manipulating the rate of exchange, but being to the detriment of the rational international division of labour. However, the functioning in the already mentioned direction is not abolished and this is of great importance for the smaller countries which are relatively more dependent upon the international exchange i.e. their autarkic development leads towards larger economic losses.

Taking into consideration the previously mentioned, it is obvious that the need for convertibility of the national currencies into world money (as an expression of uniqueness of the world production of values), irrespective of the doer of that role (the gold, convertible currencies into gold or determined national currencies, with all the limitations in their role), is being immanent in the commodity production. This rises out of the fact that the utility of the social labour being part of certain products – goods is being verified only when they convert into national and/or world money. The level of rationality of the international division of labour depends on the type of currency convertibility and the regime of the rates of exchange. Therefore, it is undeniable that the rationality is the highest under conditions of global currency and fixed rates in the cross rates of exchange.

Degradation of the institute of currency convertibility and the need of global currency

The development of the types of currency convertibility has showed that it was bypassed the evolutionary path of commodity money to world paper money. For sake of the truth, it has come to constitution of Special Drawing Rights, but it has not been continued in that direction. Instead, it has been abandoned the convertibility of dollar into gold and in fact, it has been established forced validity of currencies, but first of all, of the dollar in the developed countries. Instead of developing SDRs in the direction of world paper money, it was started the practice of placing the national currencies in the function of world paper money.

There is no doubt that the abolition of the convertibility of dollar was a logic move in the further, although paradoxical consolidation of the U.S. currency in the international finances. This most often comes to the fore by stating that the world went on to dollar standard i.e. that earlier on the international monetary system did not suit the interests of a single country to such an extent as it used to in the 1970s, particularly after the sanctioning of the practice of floating rates in the cross rates of exchange in the world.

The Americans converted the weakness of the dollar into power. By abolishing its convertibility into gold, it has fallen down the last refuge from the dollar whose purchasing power has been decreasing every day. However, the world is being forced to use the dollar in the international payments further on because SDRs are still not brought in a situation to replace the dollar in the international transactions. But, being free from the obligation to convert the dollars into gold in the world and to maintain a fixed parity, the Americans as a powerful economic force have created a space for unhindered manipulation with their own currency and its rate. This comes to the fore particularly after the decay of the Bretton Woods system under conditions of new underdeveloped international monetary system, taking into consideration the changes that were made and which continued to be in the line of solving the problems having arisen between the developed capitalist countries due to the change in the ratio of forces among them, particularly between the USA on one hand and the Federal Republic of Germany and Japan on the other hand. In the settling of their contradictions, it has been sanctioned the new type of convertibility – the exchange of one currency to other currencies (all being inconvertible into gold) at floating rates in the cross rates of exchange in the world.

It is interesting that this essential change has been overcome as something which is irrelevant, logical and even inevitable. This is completely unjustifiable because the convertibility is not a technique which is neutral in the economic events, but as it has been showed by the previous experience, it is an important category of commodity money being prone and favourable to manipulation. The convertibility of dollar into gold at a fixed price has enthroned the dollar as world money. In addition to this, the Americans were making "extra monetary profits" as a result of the crediting of the USA by the countries which were keeping dollars in their monetary reserves. After they made a practice of identifying the dollars in the world as gold, they could not resist the possibility for making even larger profits by a process of inflationary emission of dollars for international needs despite the risks of their factual inconvertibility. They soon sacrificed the prestige in their own economic interest, abolishing the convertibility of dollar into gold in order to use freely the position they obtained in the international finances through the guarantee of the exchange of dollar to gold. The change-over to currency convertibility, being regarded as exchange of one currency to another one, only permitted the currencies of the economically most powerful capitalist countries to appear in the role of dollar.

There is no doubt that the way out from the situation caused by the digression in the development of money as world money (by the determination of a dollar price on the gold and the culmination in the abolition of the convertibility of dollar into gold, the abandonment of fixed rates as well as the imposition of convertibility of one currency into another one) has to be looked for within the abolition of the reserved function of national currencies of the economically most powerful countries in the world in the international monetary relations. This is associated with the creation of world money in the full sense of the word, similarly to the way in which national money is being created within the national borders. Although, for a start, it is desirable the newly created world money to be convertible into gold, it is not the most important thing if it is led a consistent policy on keeping in the circulation as much money as there is a need of gold. On the basis of that and in the course of time, it will be completed the process of dematerialization of money at a world level. It is a matter of a system which can simulate the automatism of the gold standard.

In favour of the need for creating a global currency speaks the fact that several years, it has been discussed over global imbalances which are menacing to threaten the survival of liberal trade in the world[6], but it is obvious that they cannot be abated bilaterally. It is high time to be looked for a consequent global solution to the global problems i.e. a solution

[6] The Economists' Forum: Global imbalances threaten the survival of liberal trade, Financial Times (www.ft.com December 3, 2008).

which will be inspired not only by the interests of the whole world, but also by the interests of the countries whose currencies "are used freely". Just remember that the alternative suggestion of John Maynard Keynes for creation of a new international currency (bancor), brought forward at the Bretton Woods Conference, offers a multilateral solution on the potential global imbalances. In the line of global solution, it is also present the continuation of activities for materializing the Special Drawing Rights into a global currency of the type of commodity money, as it was the original idea.

At the beginning of the new millennium, the ratio of forces in the world is considerably changed, but it is difficult to believe that it can come to reversal soon. The economic, military and political power of the USA is still such that without their approval, it is difficult to start that process. For the time being, there are prevailing opinions among the economists that in order not to fall into strengthening of the protectionist practice, the world has to approach the equilibrium of the global imbalance. However, the path to this is seen in one direction i.e. only in decreasing the huge surpluses of separate countries, in the need for appreciating their own currencies, reducing the savings and spending more. The indications that the USA i.e. the deficient countries have to improve their productivity on behalf of the supply by increasing the national productivity, increasing the savings and reducing the current account deficit are rare. This is so because the reversal in that direction can be provided only by the creation of global currency i.e. by supplanting the national currencies in the role of world money. Because that move is eliminating the privileges of their international role, it will not probably come to reversal soon although it is inevitable. Let us hope that this will happen only before the world undergoes cataclysm out of which there will be born a global solution.

CONCLUSION

In the evolution of currency convertibility, out of the system of gold standard, there have been risen by now a lot of "types" of convertibility which, by explaining the technique, are obscuring the economic essence of the concept i.e. the need for multilateralism in the international payments.

The convertibility of national currencies into gold also provided multilateralism in the international payments. With the formation of IMF, it was consciously approached the building of a mechanism for promotion of the necessary multilateralism which provides more efficient international division of labour. The problem is that as a result of the subsequent corrections of the Fund, it has been deviated from the original meaning of the concept of currency convertibility. The creation of a practice of exchange of one currency to another one at floating rates presents a digression in the evolution of commodity money which, logically, should have ended up as world paper money (with a global currency), similarly to the gold money which have ended up as national paper money within national borders. Instead of this, the currencies of a few of the most developed economies in the world have been promoted in the function of world money, and the currency convertibility has boiled down to exchange of one currency to another one at floating rates.

The transformation of the types of currency convertibility has led to a deviation from the evolutionary path of commodity money in the process of their dematerialization. Therefore, the adjustment of the types of currency convertibility was in favour of the countries whose currencies are used freely. However, by reducing the currency convertibility to exchange of one currency to other currencies at floating rates in the cross rates of exchange in the world, it has come to reduction of the level of multilateralism in the international payments, which is an essential feature of convertibility. As a result of this, the rationality of the objective processes of the international division of labour got worse.

A reversal of the unfavourable tendency in the evolution of money and currency convertibility is possible only by creating a global currency at fixed, but adjustable rates. Only in such conditions, there will be avoided the problems of the countries whose currencies are used widely to be treated as world problems rather than national ones, which is of great importance in the world economy. However, the citizens of those countries will suffer the consequences of the unsuccessful policies and the possibility for carrying the consequences in other countries will be smaller.

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