

Fixed or flexible exchange rates –
Wolfgang Stützel vs. the German Council of Economic Experts

Johannes Schmidt*

*(Work in progress; first and very preliminary version.
Comments are very welcome.
Please do not quote without permission.)*

Abstract

WOLFGANG STÜTZEL was one of the most creative economists in Germany after WW II. Among other things, he was a member of the German Council of Economic Experts (1966-1968). STÜTZEL was a staunch defender of fixed exchange rates – a position that led to his early resignation from the Council.

By studying his literary remains at the Saarland University it was possible to study his arguments in favour of fixed exchange rates which are remarkable but partially forgotten. Furthermore, the reasons behind his resignation from the Council could be investigated in greater detail.

The study led, inter alia, to the following results:

- STÜTZEL objected against an appreciation of the D-Mark in the 1960s (and against flexible exchange rates in general) as he wanted to allow a higher inflation rate in Germany to avoid the export of inflation – he already was an opponent of the purely national view on economic policy.
- The existing correspondence makes clear that the quarrel between STÜTZEL and the other members of the Council resulted from a fundamental difference concerning the significance of dissenting opinions in the reports of the Council. STÜTZEL – in contrast to his fellow-members - wanted divergences of opinions to be disclosed.

JEL: B22, B27, B31, F31, F33

* Karlsruhe University of Applied Sciences
Faculty of Management Science and Engineering
Moltkestrasse 30
D-76133 Karlsruhe
phone: +49 (0)721 / 925-1981
fax: +49 (0)721 / 925-1947
e-mail: Johannes.schmidt@h-ka.de

1. Introduction

In the 1960s the discussion about the proper exchange rate system was in full swing. Following the classic paper by FRIEDMAN (1953) many economists proposed flexible exchange rates as they seemed to allow countries greater independence of monetary policy. In Germany the Council of Economic Experts, an advisory board for the German government, was always in favour of flexible exchange rates – a position that is defended in many reports (SCHMIDT 2019, p. 4-7).

WOLFGANG STÜTZEL (1925-1987) was an exception to the rule as he was a staunch defender of fixed exchange rates and remained extremely sceptical to the promises that were connected with the introduction of more flexibility (greater autonomy in monetary policy, decoupling from inflationary developments in other countries etc.). On the other hand, instead of bringing greater autonomy in national policy decisions he feared that flexible exchange rate would introduce additional instability in international economic relations.

In 1966, STÜTZEL was appointed a member of the German Council of Economic Experts; and the differing views on the appropriate exchange rate regime were a source of constant disputes between the majority of the Council on the one hand – with a dominating role of HERBERT GIERSCH – and STÜTZEL on the other. In 1968, STÜTZEL resigned as a member of the Council – apparently due to the irreconcilable differences concerning exchange rate policy; but apart from that STÜTZEL thought that his colleagues hindered him in an illegal way from articulating and expressing his dissenting opinion in the report(s) of the Council.

I was able to study the literary remains of WOLFGANG STÜTZEL at the Saarland University, consisting of about 50 files with his published and unpublished papers as well as 6 files containing documents about his term at the Council. The aim of this consultation (and the content of this paper resulting from this consultation) was, initially, to retrace the arguments concerning fixed vs. flexible exchange rates, as they can still be important – all the more as STÜTZEL used remarkable arguments that have been partially forgotten. Furthermore, another aim was the clarification of the background of STÜTZEL's resignation from the Council.

The paper is structured as follows: in chapter 2 STÜTZEL's position concerning exchange rates is explained. Basically, his defense of fixed exchange rates is founded on the conviction that exchange rates are not simple purchasing prices that should be allowed to move freely according to the forces of supply and demand but bear a stronger resemblance to the face value of a bond which is not allowed to flow freely but is fixed as the current price of a bond is formed in relation to the fixed face value. Chapter 3 sketches the disputes between STÜTZEL and the Council: whereas the differing opinions could yet be reconciled in the first yearly report that the Council delivered in 1966 after STÜTZEL became a member, there were serious quarrels concerning the compilation of the second yearly report in 1967 as STÜTZEL thought that his considerations concerning government debt were not adequately represented in the final report. The disputes escalated in 1968 when the Council was expected to deliver a special report concerning the appreciation of the German Mark, and STÜTZEL wanted to express his differing opinion in a minority statement. As STÜTZEL thought that his colleagues hindered him from properly expressing his opinion he resigned from the council. The resignation was heavily discussed in the

public; finally, an arbitration panel was installed that conceded that STÜTZEL was indeed restricted in his rights by the decisions of the council concerning minority votes. Section 4 draws some conclusions for today's discussions.

2. STÜTZEL' s Views on Exchange Rates

STÜTZEL' s argument for fixed exchange rates¹ had two important parts:

- The distinction between simple purchasing prices (“einfache Kaufpreise”) and prices that equilibrate the distribution of stocks (“Bestandshaltepreise” – stock-equilibrating prices).
- The analogy between an exchange rate and the face value of a bond.

2.1 Purchasing Prices vs. Stock-Equilibrating Prices

Simple purchasing prices (€/piece or €/kg or other expressions of the same kind) are useful for equilibrating *flows*, e.g. supply and demand of a good in a certain period. These prices are a relation between two objects: the good to be purchased/sold and the money given in exchange for the good. But the transactions on international accounts are much more about the equilibration of the distribution of *stocks*, that is: equilibrium means that each economic agent is content with the distribution of stocks and does not want to restructure them. Problems concerning the balance of payments refer to the explanation of balances – balances in the current account and balances in the financial account. STÜTZEL starts with the logical truism that the current account balance is simply the sum of the net financial balances (balances of revenues and expenditures) of the inhabitants of a country. Balances in the current account show changes in the *amount* of (net) financial assets the economic subjects in a country hold regardless of its structure. If one wants to explain balances in the current account that is equivalent to saying that one wants to explain the increase or decrease of net financial assets the inhabitants of a country hold. Capital movements that are recorded in the financial account show changes in the *structure* of net financial assets. To explain these movements one has to explain why people change the structure of the financial assets they hold.

For STÜTZEL it is not possible to explain current account balances or capital movements by referring to simple purchasing prices but one has to take into account that holders of a (financial) asset who have to decide whether they want to keep the asset or consume it are interested in the change of the purchasing power of their stock – the expected real interest rate on their financial assets; an investor who invests in bills of exchange is not primarily interested in the current purchasing price of the bill but in the (intertemporal) difference between the current price and the repayment sum (STÜTZEL 1969, p. 11 f.) Interest rates and intertemporal price differences are the most important examples for these stock-equilibrating prices. They always have the dimension “€ per piece *and* per unit of time”. Therefore, balances in the balance of payments cannot be explained by exchange rates as such but by (expected or contractually agreed)

¹ His arguments can be found in several writings: partially in the fourth chapter of his treatise on “balance mechanics” (STÜTZEL 1978) and in a paper (STÜTZEL 1969) that grew out of a lecture he delivered in 1969. The following description refers mainly to the latter source.

changes of exchange rates, (expected or contractually agreed) changes in prices / price levels, or by interest rates. All these prices have a time dimension and belong to the stock-equilibrating prices. Equilibrium in international transactions can have several dimensions (STÜTZEL 1969, p. 15 ff.):

- For an equilibrium in the sense of a non-arbitrage condition the difference in nominal interest rates must be equal to the difference between spot exchange rate and forward exchange rate, that is the covered interest parity has to be fulfilled – a condition that Stützel thinks is practically always fulfilled (STÜTZEL 1983, p. 23 ff.)
- A speculative equilibrium requires the equality between the countries' interest rate differences and the expected depreciation of the currency of the country offering higher interest rates, that is the uncovered interest parity has to be fulfilled.
- For an encompassing equilibrium – including also the participants on the markets for goods and services – an increase in inflationary expectations in a currency has to be compensated by an equal increase in nominal interest rates in this currency.

An overall equilibrium therefore requires the equality of the following quantities:

- Interest rate differences between different currencies
- Differences in inflationary expectations
- Expected changes of exchange rates
- Swap rates (differences between spot and forward exchange rates)

An important proposition of STÜTZEL's theory is that stock-equilibrating prices (interest rates in a wider sense) also determine the balances of revenues and expenditures of economic subjects and therefore also the current account balances of a country.

This has important consequences for the effect of appreciations and depreciations (STÜTZEL 1969, p. 17 f.):

A depreciation can reduce or eliminate a current account deficit only when the expected real interest rate increases (so that economic subjects are willing to hold larger amounts of net financial assets in the currency of the country with the current account deficit. Given nominal interest rates, the real interest only increases if expected inflation goes down. But the depreciation itself will, in the first place, increase the expected inflation rate. So the improvement in the current account will only come about if the increase in inflationary expectations is (more than) compensated by a large increase in nominal interest rates. Without such an increase in interest rates the depreciation will only be successful if economic subjects can be persuaded that in the future the inflation will be lower than before.

An appreciation, on the other hand, will decrease a current account surplus only if – despite the reduction of the inflation rate as a first-round result of the appreciation – the real interest rate in the country decreases. For that to happen, the nominal interest rates would have to be lowered sharply so that the propensity to go into debt increases despite the decrease in inflation.

In short: If there are any prices in the realm of international exchange that equilibrates balances, however defined, then – according to STÜTZEL – it can never be the exchange rate or its changes as such that determines the effect on the balance of payments but the influence of the exchange

rate change on nominal interest rates, inflationary expectations and expectations concerning future changes of exchange rates.

Due to these very unstable expectations – especially concerning expectations about future exchange rates – STÜTZEL denies that flexible exchange rates are able to fulfill the hopes that were connected with their introduction in the 1970s. Consequently, in an assessment of the experiences of a decade with flexible exchange rates (STÜTZEL 1983) he stated that practically all promises connected with exchange rate flexibility turned out to be empty:

- they did not counterbalance differences in inflation rates between countries
- they did not reduce current account balances
- due to capital mobility, monetary policy did not enjoy more autonomy but had nevertheless to take into account external factors – a point that was emphasized recently by HELÈNE REY (2013) who said that the traditional trilemma of monetary policy is in fact a dilemma
- they did not allow more scope of action concerning business cycle policy

On the other hand, the level of the exchange rate itself is quite unpredictable in a system of flexible exchange rates. STÜTZEL is convinced that the simple idea that the *level* of an exchange rate follows the purchasing power parity or can be derived from the interest-parity condition is wrong: differences in interest rates between countries determine only the percentage *difference* between the spot and the forward rate, but not the *level* of the exchange rate. Its level depends on many factors which cannot, he is convinced, be derived from economic models: and suggesting that it can is scientifically outrageous (“wissenschaftliche Frevelei” – STÜTZEL [1983], p. 37).

The main mistake, according to STÜTZEL, is a naïve transfer: in a normal goods market, flexible prices fulfill a stabilizing function: if a good becomes more scarce, the resulting price increase leads to an increase of the quantity supplied and a decrease of the quantity demanded; and this idea is erroneously transferred to the situation on the foreign exchange market. But on this market two effects might become important: if the exchange rate changes that could lead to changes in many other prices (“Mitreißer-Effekt” – STÜTZEL [1983], p. 10 f.) so that there is no stabilizing effect on relative prices but a general increase in the price level. On the other hand an increase in a price could lead to the expectation that it will increase still further in the future leading to additional purchases instead of a reduction in the quantity demanded; the (potential) sellers of the good will reduce the amount they are willing to sell in order to realise still greater gains in the future. Both effects will lead to further increases in the price (“sich selbst verstärkender Erwartungs-Änderungs-Effekt” – STÜTZEL [1983], p. 12 f.)

All these considerations want to show that the level of exchange rates cannot be determined with an adequate precision as this level depends on the expectations of the future exchange rate – and this expectation is quite volatile and cannot be determined.

Proponents of flexible exchange rates counter these arguments that these large fluctuations are only the result of an economic policy that lacks the necessary consistency. In Germany, one of the main proponents of this position was the Council of Economic Experts (SCHMIDT 2019, p. 4 ff.). In several of its annual reports the council defends the worldwide “system” of flexible exchange rates against arguments doubting its usefulness and stability. The common theme of

the council's argumentation here is that the seeming instability of flexible exchange rates mainly comes from the instability and the lacking consistency of economic policy. If the countries, so the argument goes, followed a policy of stability-oriented, foreseeable and consistent economic policy, stable exchange rates would result, as the economic actors are able to build stable exchange rate expectations. Transitory problems should not be a reason for abolishing flexible rates (annual report 1974/75, p. 21) as they make life easier for monetary policy and allow to have inflation rates different from other countries (annual report 1974/75, p. 165). All in all, the council seems to be convinced that, at least in the long run, exchange rates move according to the purchasing power principle. This support for flexible rates is repeated in later reports: the council sees the large fluctuations but explains them with the lacking practice with flexible rates and reminds the politicians that a convergence in economic policy is the right way to stabilise exchange rates and exchange rate expectations (annual report 1975/76, p. 166).

STÜTZEL would see these arguments as a clear confirmation of his conviction that flexible exchange rates would not bring much greater autonomy in economic policy but that the necessity to take into account international factors still holds – only the aim has changed: whereas in a fixed exchange rate system monetary policy has to ensure that the stock of foreign currency reserves is not depleted, in a flexible exchange rate system one has to avoid large swings in exchange rates. But then, STÜTZEL would surely reply, one could have stucked to fixed parities in the first place.

2.2 Exchange rates as Provisions of the Terms of Debt

That leads to the second part of STÜTZEL's argument in favour of fixed exchange rates. For him, an exchange rate is not a simple purchasing price but a promise to pay a certain amount, comparable to the face value of a bond. The current price of a bond which is determined on the capital market can only meaningfully be found in relation to its – invariable – face value. The face value provides the terms of debt (“Schuldinhalts-Bestimmungszahlen” – STÜTZEL [1969], p. 21) and in the relation to these terms the current price is formed. If one made the face value of a bond variable the capital market would lose the anchor for pricing the current value of the bond. His example (STÜTZEL 1969, p. 21) is a 7% bond: if the issuer decides (assuming that he/she is allowed to do so) that the amount to be repayed (and to be paid interest on) is itself decided by the current valuation on the capital market an overregulated system would result: if the market interest rate is above 7% at the moment, a current value of 97 would be too high as also the amount to be repayed will only be 97 and the interest would also be payed on 97 – therefore, the price will decrease further which also reduces the amount to be repayed and therefore will lead to a further decrease of the price. If the current interest rate is below 7%, the price of the bond would permanently increase and with changes in the market interest rates we would have wild swings in bond prices as the anchor for forming reasonable price expectations has been removed. For him, such a move is comparable to a situation in a heating system where the scroll bar that regulates the set-point temperature is untightened from its lock and linked to the needle showing the actual temperature. If the heating is on, then the temperature will rise which will also rise the set-point temperature; if the heating is off, then the temperature will fall which also decreases the set-point temperature.

According to STÜTZEL, currency parities should be regarded more like terms of debt and not like current prices. The connecting factor he mentions is the gold standard in which each currency had a certain gold parity and the exchange rates between currencies were fixed to reflect these gold parities. And that was still the case in the system of Bretton Woods: a parity guaranteed a certain amount of foreign currency. For STÜTZEL, giving up fixed parities is exactly the same as giving up the immutability of a bond's face value. The point here is, again, that in a regime of flexible exchange rates the level of an exchange rate crucially depends on the exchange rate expectations – and these expectations are, by their very nature, extremely volatile and do not follow a simple rule like the purchasing power parity. And the policies that have to be followed to avoid extreme exchange rate fluctuations are not very different from the policies that have to be followed in a fixed exchange rate regime.

“Regardless whether you have fixed, stepwise floating or free-floating exchange rates – one does not get around the simple rule that a country whose currency is expected to depreciate has to hold up with appropriately higher interest rates (and a slowdown of wage increases), if one wants to preserve freedom of movement and prevent a cumulative decline of the currency.” (STÜTZEL 1983, p. 21, my translation)².

It might be that in extreme cases a change in parities might be necessary or unavoidable but for STÜTZEL such changes have to be the absolute exception. Again by referring to the face value of a bond: if a debtor declares that he is not able to repay the full amount of the bond that is not a sign of flexibility but it means breaking a contract and a promise. It can happen but it should be the exception, not the rule. The promise connected to fixed parities is a promise given by governments, not private agents. But for STÜTZEL, this promise is of equal importance for the functioning of a market economy. Apart from the position that the hopes connected with flexible exchange rates have not been fulfilled and that certain economic adjustment cannot be avoided regardless of the exchange rate regime STÜTZEL was against changing parities as a normal instrument of economic policy because it would nourish the illusion that only by changing parity relations one can improve the economic situation and avoid trade restrictions and currency crises. This, in turn, would reduce the internal efforts of a country and diminish the probability of success of parity changes (STÜTZEL 1969, p. 31).

3. The Dispute between STÜTZEL and the Council of Economic Experts

“The German Council of Economic Experts is an academic body that advises on economic policy issues. Set up by law in 1963, it is mandated with the task of providing an impartial expert view in the form of periodic assessments of macroeconomic developments in Germany, thus helping economic policymakers and the general public to make informed decisions. The Council is fully independent in its advisory role and operates in a transparent manner. It describes the current economic situation and its likely future development, highlighting any adverse trends and possible ways of averting or mitigating them. To this end it discusses various indicators of economic output, quality of life, sustainability, and politically defined targets. It also analyses the progress, opportunities and risks of current economic policies and identifies potentially conflicting objectives. The Council's reports and

² In the original: “Ob feste, ob stufenweise, oder ob ganz frei schwebende Kurse – um die Bauernregel, daß ein Land, von dessen Währung man einen Kursrückgang erwartet, mit entsprechend höheren Zinssätzen (und einer Bremsung des Lohnanstiegs) gegenhalten muß, wenn es die Freizügigkeit erhalten und einen kumulativen Währungsverfall vermeiden will, um diese Bauernregel kommt man mit keinem Trick herum.“

assessments form a key part of the economic policy debate in Germany and have significantly influenced the political decision-making process.”³

Since its set-up in the beginning of the 1960s, the German council of Economic Experts has given many statements regarding the exchange rate system in general and the exchange rate policy in Europe in particular. From the start, the (majority of the) council was in favour of flexible exchange rates.⁴ The background of this position was the situation in the Bretton Woods system in the 1960s: increasing inflation and fixed parities. A majority of economists at that time supported the introduction of flexible exchange rates; but as long as the Bretton Woods system existed they supported an appreciation of the German mark to secure internal price stability.

3.1 STÜTZEL’S Position Concerning the Appreciation of the German Mark

STÜTZEL was appointed a member of the council in February 1966. The other members were; WILHELM BAUER, head of the RWI (Rheinisch-Westfälisches Institut für Wirtschaftsforschung) and chairman of the council; HERBERT GIERSCH, Professor at the Saarland University (and later head of the Kiel World Economic Institute); HARALD KOCH, former minister, former member of the board of directors of the Hoesch AG and now a member of the supervisory board of Hoesch; MANFRED SCHÄFER, shareholder of the Röchling Bank GmbH and member of the economic council of the CDU. In the first years of the council it was not common practice that only university professors could become members of the council.

STÜTZEL was an opponent of the parity change. Both he and colleagues agreed that in the situation at that time of rising inflation rates all over the world it is not possible to fulfill at the same time all four aims of the German act for the promotion of stability and growth of the economy (“Gesetz zur Förderung der Stabilität und des Wachstums der Wirtschaft”): high employment, stable price level, external equilibrium⁵ as well as steady and appropriate economic growth. But they differed in their opinion which aim should be (temporarily) suspended: whereas STÜTZEL pleaded for a temporarily higher inflation in Germany (see below) the other members of the council were strongly in favour of an appreciation of the German mark as an external hedge (“außenwirtschaftliche Absicherung”) of internal (price) stability.

Already in its first annual economic report the council sympathised – based on a report by FRIEDRICH LUTZ and EGON SOHMEN – with a regime change towards flexible exchange rates: such a system would offer to each country the possibility to go for the economic targets that correspond to its economic and socio-political preferences (annual report 1964/65, p. 134). This support of flexible exchange rates was a common theme in the reports to come. Only in the reports of 1966/67 and 1967/68, the council discussed possibilities of securing internal stability without giving up the system of fixed exchange rates.

In the report of 1966/67 the council discussed three possibilities for an “external hedge” (“außenwirtschaftliche Absicherung”) of the stabilisation policy – a policy that is to deliver a

³ This information is taken from the Council’s website: <https://www.sachverstaendigenrat-wirtschaft.de/en/about-us/objectives.html> For further information see the appendix..

⁴ An overview of the council’s position and its development in the course of time can be found in Schmidt (2019), p. 4-8.

⁵ This aim was normally identified with a balanced current account but can – at least at the time of its enactment in 1967 – also be understood as a situation where the exchange rate stays constant or is not under pressure of appreciation oder depreciation (which does not necessarily imply a situation of a balanced current account).

low inflation rate even if other countries have higher inflation rates –: a hardened currency standard (“gehärteter Devisenstandard”), a guaranteed parity increase in the medium term, and a widened margin of fluctuation in combination with limited increase of the parity (appreciation of the German mark).

The remarks about the hardened currency standard clearly bear STÜTZEL’s signature. They are driven by the idea that Germany should try to persuade other members of the Bretton Woods system to follow stricter rules concerning price stability: they should even better forgo full employment instead of price stability or – if they do not want to relinquish a policy for full employment – introduce some kind of incomes policy instead of trying to depreciate their currencies. Furthermore, they should abstain from any restrictions of capital transactions and not discriminate non-residents against residents; for countries that have not reached a full convertibility of their currencies should be induced to converge to it by making the access to credit facilities dependent on the abolition of rules inhibiting convertibility. In such a scenario, fears about higher inflation in a country would lead to capital flight; as the currency reserves of the central bank decrease interest rates in the money markets would rise (as the currency reserves of a central bank can only be paid with central bank money) and stop the capital flight in the end. A problem could be that the country losing currency reserves is forced to a restrictive policy whereas the country capital is transferred to is not forced to carry out an expansive policy. The report – or STÜTZEL in this case – makes clear that such a fixed exchange rate system has a certain anti-inflationary (or even deflationary) tendency; but in times of worldwide inflation that is seen as a benefit (annual report 1966/67, p. 150).

But the (majority of the) council seemed to see the chances of realizing such a policy as rather dim so that parity changes were seen as a possible policy tool – an idea STÜTZEL regarded with great scepticism – and the discussions on these different possibilities seemed to have been intense to say the least, especially between STÜTZEL and GIERSCH. In a letter to the arbitration panel that was installed after STÜTZEL’s resignation GIERSCH wrote that already in this report he and STÜTZEL had grappled with each other, wearied each other down, and blocked themselves mutually.

Concerning the situation at the end of the 1960s STÜTZEL formulates his position (after his resignation) in two articles that are of particular interest also for the current discussion in Europe: an interview with the weekly paper “Der Volkswirt” (STÜTZEL 1969a) and an article in the weekly paper “Die Zeit” (STÜTZEL 1969b).

In the interview STÜTZEL doubts that the proposition of pent-up price increases is as reliable as many economists think: changing the reference period leads to differing assessments, and in his opinion the purchasing power between German and foreign currencies is not so divergent that it cannot be relieved without parity changes. “Whether an exchange rate is wrong or not always depends on what you consider it to be. In my opinion the exchange rate is correct and the unit labour cost are a little bit ‘wrong’; but they can adapt to the parity in a few months or years.” (Stützel 1969a, p. 16, my translation⁶) For STÜTZEL that meant a certain inflationary adaptation for Germany and he considered that the price to be paid for sticking to the fixed parity. He

⁶ In the original: „Ob ein Wechselkurs falsch ist oder nicht, das hängt immer davon ab, als was Sie ihn ansehen. Meiner Meinung nach ist der Wechselkurs richtig und sind die Lohnkosten je Produkteinheit zum Teil etwas ‚falsch‘; diese könnten aber in ein paar Monaten und Jahren wieder in die Parität hineinwachsen.“

regarded an appreciation as a beggar-thy-neighbour policy: appreciation means an export of inflation in the same way as a depreciation means an export of unemployment. The right way for him was:

“In our world in the last third of the 20th century, the Federal Republic of Germany has to accept so much internal price increases as it just has to if it does not want to change the parity and at the same time export so much stability as is just acceptable so that the export of deflation does not lead to mass unemployment in other countries. One should work exactly in this intermediate field.” (STÜTZEL 1969a, my translation)⁷

For him, the wish to isolate Germany from the inflationary developments by appreciation is an act of monetary nationalism (STÜTZEL 1969b)⁸ that Germany should desist from.

“I still believe that the German saver is still willing to lose two or three percent of the domestic value of money if he could for that price of a price level increase, on the other side, trust in a common European currency and that the national borders in the economy fall completely. When I am against appreciation then the last reasons for that are that I imagined the development after the Second World War differently. I believe that we should not practice again ‘national economic policy’ in a way that is seen as necessary by some interpreters of the German Act for Stability and Growth. For me, these interpretations are simply too narrow-minded and provincial, they have not enough gentlemanly.” (STÜTZEL 1969a, my translation)⁹

3.2 The Quarrels in the Council and STÜTZEL’s Resignation

The protocols of the debates in the council – as far as they could be found in STÜTZEL’s literary remains¹⁰ show that there were quarrels about the significance of exchange rate policy from the start of STÜTZEL’s term. Whereas STÜTZEL is very reluctant to accept parity changes or the introduction of flexible exchange rates the majority of the Council was much more willing to change parities. It seems to be the case that the differences could be reconciled in the first report by presenting the different strategies but that this was only grudgingly accepted by STÜTZEL.

During the preparation of the second report during STÜTZEL’s term there were disputes about government debt and the report should contain a chapter on it. STÜTZEL prepared a larger text with the balance mechanics of government debt and discussed, above else, the different meanings of the term “deficit” – STÜTZEL was very fond of these terminological clarifications as in his opinion many debates in economics resulted from the lack of clarification concerning the

⁷ In the original: „Die Bundesrepublik muß soviel Binnenpreissteigerung hinnehmen, wie sie eben hinnehmen muß, wenn sie die Parität nicht ändern will, und gleichzeitig soviel Stabilität exportieren, wie eben noch erträglich, damit der Deflationsexport nicht gerade in anderen Ländern zu Massenarbeitslosigkeit führt. Genau in diesem Zwischenfeld sollten wir arbeiten.“

⁸ Interestingly, STÜTZEL’s position is very similar to HAYEK (1937) but STÜTZEL never quotes him. It is unclear whether STÜTZEL did not know HAYEK’s position (which seems improbable) or what were the reasons of disregarding him.

⁹ In the original: „Ich glaube immer noch, der deutsche Sparer würde bereit sein, zwischendurch einmal zwei oder auch drei Prozent am Binnengeldwert zu verlieren, wenn er auf der anderen Seite darauf vertrauen könnte, daß wir um diesen Preis einer Preisniveausteigerung demnächst eine gemeinsame Europawährung haben werden und daß um diesen Preis die nationalen Grenzen in der Wirtschaft vollends fallen würden. Wenn ich gegen Aufwertung bin, dann sind die letzten Gründe eben darin zu suchen, daß ich mir nach dem Zweiten Weltkrieg die Entwicklung ein bißchen anders vorstellte. Ich glaube, daß wir nicht wieder ‚Nationalwirtschaftspolitik‘ oder ‚Nationalökonomie‘ jener Preislage betreiben sollten, wie sie manche Interpreten des deutschen Gesetzes zur Stabilität und zum Wachstum als geboten ansehen. Diese Interpretationen sind mir einfach zu kleinkariert-provinziell. Sie haben mir einen zu starken bundesnationalstaatlichen Einschlag. Sie sind mir zuwenig weltmännisch.“

¹⁰ Unfortunately the protocols of this period could not be found in the archive of the council. Apparently, they got lost during moves or were simply discarded to create additional space.

meaning of words and terms. Furthermore, he discussed at length that government debt or deficit is not equivalent to disorder, inflation, money creation, increase of expenditures, crowding out; he pleaded for greater government debt to compensate private surpluses and the German current account surplus – without higher government deficits there was, he insisted, no chance to reduce the current account surplus.

As his colleagues considered the chapter too long he created a shortened version of it, but in the final report this version did not show up but another version about which he did not know where it came from; it was apparently created by the assistant of another council member. Against his vote some parts he considered important were shortened or deleted (e.g. the rejection of fears that government debt necessarily means excessive money creation or excessive inflation and that debt management could work as relief concerning tasks in foreign exchange policy; instead the final version contained, in his opinion, an unduly discussion of technical problems. Already in this discussion he threatened to deliver a minority vote – a possibility that is explicitly mentioned in § 3 par. 2 of the Act on the Council of Economic Experts (“Sachverständigenratsgesetz” – SVRG) but this possibility had not been used by a member so far, and it was not realised in the preparation of the 1967 report.

In June 1968 the situation started to escalate: the council was expected to deliver a special report on the macroeconomic perspectives; the first draft was of the mind that the external economic disequilibrium could only be eliminated either by an internal inflation or by an appreciation of the currency. As the (majority of the) council saw inflation as strictly forbidden, it pleaded for appreciation. The special report should be delivered to the German chancellor in a personal meeting on 3rd July 1968.

STÜTZEL disagreed, and he drafted a lengthy paper where he stated that the reduction of the current account is not as large or threatening as usually thought and might decrease by itself without parity change. He doubted that the assumptions lying behind the majority’s opinion were as certain as the majority believed (import elasticity, prices of internationally traded goods, stringency of the direct international connection of prices; length of the period in which price stability has to be reached) For him, there was a political risk that a country that appreciates will also depreciate in the future; furthermore, he doubted, as was shown in chapter 2.2, the compatibility of parity changes with the liberal market order. But he agrees that it is not possible to promise at the same time price stability, high employment, external equilibrium, steady growth, and stable exchange rates. But STÜTZEL pleaded for a (temporary) greater inflation – “adjustment inflation” as a concession to countries with higher inflation rates to preserve stable exchange rates.

In the meeting on July 3rd, shortly before the meeting with the chancellor, WILHELM BAUER, chairman of the council, was deeply worried that a minority vote would damage the reputation of the council, and HERBERT GIERSCH saw the council’s ability to work threatened with the current composition of the council; he threatened with resignation and pleaded for cancelling the meeting with the German chancellor. BAUER opposed to that as he himself had prepared the meeting.

STÜTZEL proposed to deliver the theses of the (majority of the) council and his minority vote to the chancellor; this possibility was rejected by the other members. In the end, the analysis was

presented to the chancellor only orally; a short paper that was passed in the meeting was only a note for the oral presentation; only in the last paragraph of this paper one could find a hint that one member of the council had a different opinion. STÜTZEL did not intervene during the meeting with the chancellor.

In its meeting on 12th July – HARALD KOCH was absent – the council had to decide which papers should be sent to the German government. There were three possibilities:

- a) the written version of the orally presented short report, the detailed “theses concerning macroeconomic development” *and* STÜTZEL’s minority vote; this proposal was supported by STÜTZEL, rejected by BAUER and SCHÄFER, GIERSCHE abstained.
- b) the written version of the orally presented short report, the detailed “theses concerning macroeconomic development” *without* STÜTZEL’s minority vote; this was rejected by BAUER, SCHÄFER and STÜTZEL, GIERSCHE abstained again.
- c) only the written version of the orally presented short report; this was supported by BAUER, SCHÄFER and STÜTZEL, GIERSCHE abstained again.

During the same meeting there was a heated discussion on the cooperation within the council. The protocol does not show the whole discussion; according to handwritten notes STÜTZEL attached to the protocol of the meeting (and in which he seemed to formulate an amendment to the protocol) GIERSCHE demanded that the council should unanimously vote on principles of cooperation so that the difficulties of the preceding weeks should not come up again. STÜTZEL offered that a rule should be passed that dissenting opinions have to be announced no later than 48 hours after a draft has been submitted but GIERSCHE thought this promise to be insufficient. In the end the council took the following decision (according to the protocol of the meeting – my paraphrase):

“1. Each council member is entitled to formulate a dissenting opinion but this must not lead to a blockade of the council’s work; each council member assumes that formulating an extensive minority vote, that goes beyond a dissenting opinion concerning individual questions means endangering the existence of the council or its current composition. Therefore, each council member will demand the acceptance of a minority vote only if he can claim serious reasons for it. A rejection of such a proposal by the majority of the council will lead the proposer to personal consequences.

2. By ‘foreseeable development’ (‘absehbare Entwicklung’) according to § 2 SVRG the council means a period of about two or three years, as far as the aims ‘high employment’, ‘price level stability’, ‘external equilibrium’ and their realisation are concerned. The council will take into account longer periods only if the majority deems that as necessary for fulfilling its legal mandate.”¹¹

¹¹ In the original (protocol of the 94th meeting of the Council of Economic Experts, July 12th/13th, 1968):

1. Jedes Mitglied des Sachverständigenrates geht bei der gemeinsamen Arbeit davon aus, daß es ihm unbenommen ist, seine von der Mehrheit abweichende Meinung zu formulieren und für die Öffentlichkeit erkennbar zu machen. Diese Möglichkeit, ein Minderheitsvotum abzugeben, darf nach der übereinstimmenden Ansicht aller Mitglieder nicht dazu führen,

The first point was accepted by all members, including STÜTZEL – but probably only grudgingly as other members threatened with resignation if it is not accepted unanimously. STÜTZEL vehemently objected to the second point as he thought that the majority could prohibit the minority (that is: him) to consider longer periods. It seems clear that this would work as a direct hindrance for Stützel as his arguments that an appreciation is not necessary were derived from medium- to longer-term considerations. Stützel's fear seemed to be justified as a softer version that did not mention a majority decision had been supported by Stützel but was rejected by GIERSCH.¹²

In August 1968 STÜTZEL – in a letter to BAUER – made clear that in his opinion it is not the differing stance on exchange rates that lie at the heart of the tensions but differing opinions about the appropriate way for the council to fulfil its task. According to STÜTZEL, the other members attached too much importance to a preferably coherent outward appearance. But for STÜTZEL it would be inappropriate to cover different opinions – just the contrary: to promote a proper judgment in the public the council would be well-advised to let know the internal dialogue. Therefore he demanded in the same letter that the council should assert that no decision of the council concerning its operations should be interpreted as an attempt to restrict the possibility of minority votes that does not follow from the SVRG or general legal principles.¹³ A rejection of this proposal, STÜTZEL stated, would lead to personal consequences on his side. Stützel also obtained two legal opinions concerning minority votes and the legality of the decision of July 12th.

In its meeting on September 10th, the council agreed on this proposal but it said "...as an attempt to restrict *with legal effect* the possibility..."¹⁴ As STÜTZEL was not content with that and still feared that the second part of the decision of July 12th could be used against him he demanded that the council states explicitly that questions like the one he treated in his paper concerning

daß die Arbeit des Rates blockiert und ihm die Erfüllung seines gesetzlichen Auftrags bis zur faktischen Unmöglichkeit erschwert wird.

Jedes Mitglied des Sachverständigenrates geht gleichermaßen davon aus, daß die Abgabe eines umfassenden Minderheitsvotums, das über die abweichende Auffassung zu einzelnen Fragen hinausgeht, gleichbedeutend ist mit einer Gefährdung der Existenz des Sachverständigenrates oder seiner derzeitigen Zusammensetzung.

Jedes Mitglied des Sachverständigenrates wird daher die Respektierung eines Minderheitsvotums nur dann verlangen, wenn es schwerwiegende Gründe dafür geltend machen kann. Lehnt die Mehrheit einen solchen Antrag ab, so wird dies den Antragsteller zu persönlichen Konsequenzen veranlassen.

2. Unter der absehbaren Entwicklung nach § 2, Satz 1 des Sachverständigenratsgesetzes versteht der Rat grundsätzlich einen Zeitraum von bis zu zwei Jahren, soweit es die drei Ziele „Stabilität des Preisniveaus“, „hoher Beschäftigungsstand“ und „außenwirtschaftliches Gleichgewicht“ und ihre Verwirklichung betrifft. Längere Zeiträume wird der Rat in die vorausschauende Betrachtung dieser drei Ziele und deren Verwirklichung nur dann einbeziehen, wenn seine Mehrheit die Auffassung vertritt, daß dies zur Erfüllung seines gesetzlichen Auftrags notwendig ist.“

¹² This other version that STÜTZEL would have approved, was (according to the statement of the arbitration panel, p. 9): “Die Mitglieder des Sachverständigenrates stimmen darin überein, daß für die Gewährleistung jedes drei Ziele ‚Stabilität des Preisniveaus‘, ‚hoher Beschäftigungsstand‘ und ‚außenwirtschaftliches Gleichgewicht‘ dieselbe Zeitspanne gilt, nämlich die absehbare Entwicklung im Sinne des § 2 Satz 1 des Gesetzes; darunter versteht der Rat einen Zeitraum bis zu zwei Jahren. (Zusatz KOCH:) Das bedeutet nicht, daß der Rat nicht auch die Folgen der von ihm erörterten Maßnahmen für spätere Zeiträume im Auge zu behalten hätte (Zusatz SCHÄFER:), soweit es zur Erfüllung seines gesetzlichen Auftrages notwendig ist.“

¹³ The proposal in the original (according to the statement of the arbitration panel, p. 10: “daß kein bisher ergangener Verfahrensbeschluß als Versucht interpretiert werden kann, die Möglichkeit, die § 3 Abs. 2 des SVRG jeder Minderheit garantiert, in einer Weise einzuengen, die nicht aus dem Gesetz selbst oder aus allgemeinen Rechtsgrundsätzen folgt“.

¹⁴ The decision in the original (according to the statement of the arbitration panel, p. 14): “Der Sachverständigenrat bestätigt, daß selbstverständlich der am 12. Juli 1968 zum Thema ‚Zusammenarbeit im Sachverständigenrat‘ gefaßte Beschluß nicht als Versuch interpretiert werden kann, die Möglichkeit, die § 3 Abs. 2 des Gesetzes über den Sachverständigenrat jeder Minderheit garantiert, *mit rechtlicher Wirkung* einzuengen.“ (emphasis in italics added)

the special report of the council are not seen as a violation of the principles of cooperation as decided on July 12th.¹⁵ In STÜTZEL's absence the decision on this proposal was postponed.

On September 13th there was another discussion on the cooperation in the council. STÜTZEL stated that he wanted to reach the revocation of Nr. 2 of the decisions of July 12th he had not accepted. The decision was postponed until September 19th.

On September 19th BAUER indicated STÜTZEL's proposal as an unacceptable ultimatum and threatened to resign from his post as chairman of the council; he and other members threatened with resignation from membership if STÜTZEL insisted on his proposal. After an interruption of the meeting STÜTZEL resigned.

STÜTZEL's resignation and the reasons for it were heavily discussed in the press. After several articles and a letter to the editor by HARALD KOCH, STÜTZEL issued a statement saying that the council made unlawful decisions concerning the acceptable content of minority votes and held unlawful meetings without inviting the minority. This behaviour, he stated, prevented him from expressing his opinion in the report of the council, herefore he resigned.

In accordance with STÜTZEL the council decided on installing an arbitration panel, consisting of the Professors KLAUS STERN and FRITZ NEUMARK and the president of the Higher Regional Court (Oberlandesgericht) Saarbrücken, ROLF BEST.

The court decided in 1973 that the decision of the council of July 12th 1968 indeed violated STÜTZEL's rights in so far as it restricts the possibility of expressing a minority vote – which is unlawful in light of § 3 par. 2 SVRG and as it restricts the “foreseeable development” to a period of 2 years and binds deviations to a majority vote.

The panel stated that the distinction between an extensive minority vote and a dissenting opinion on single questions and the assessment of a danger for the council's existence is nothing but the exercise of pressure on the dissenter; furthermore it is not compatible with § 3 Abs. 2 SVRG to demand serious reasons for the formulation of a minority report. Similarly, restricting the period under consideration to 2 years is arbitrary and scientifically indefensible. The panel showed by quoting other report of the council that it often considered longer-term developments itself.¹⁶

4. Conclusion

The quarrels WOLFGANG STÜTZEL had with the other members of the German Council of Economic Experts shortened his term; but the debates his resignation set in motion breathed life in a regulation that was stipulated in the law but had no counterpart in the actual proceedings of the council. Before STÜTZEL's term the council members seemed to think that – apparent – unanimous agreement was necessary for the council's reputation. STÜTZEL begged to differ –

¹⁵ In the original (according to the statement of the arbitration panel, p. 14: “Fragen die in Anlage 3 des Protokollentwurfs der 93. Sitzung behandelt werden (STÜTZEL's dissenting opinion to the council's special report concerning appreciation), im Rat mit dem Ziel zur Diskussion zu stellen, daß die Gutachten des Rats auf diese Fragen eingehen, wird nicht als Verstoß gegen die am 12. Juli 1968 festgestellten Prinzipien der ‚Zusammenarbeit im Sachverständigenrat‘ angesehen.“

¹⁶ STÜTZEL also rephended the holding of informal meetings by the other members of the council which he thought conduced to excluding him from deliberations. But the panel did not follow him in this point.

and it is only a slight exaggeration to say that he paved the way for an increased use of dissenting opinions by later members of the council.

Apart from that, the paper showed some important arguments that STÜTZEL brought forward to defend fixed exchange rates. In retrospect one can say that he was right in his scepticism concerning the benefits of flexible exchange rates. The difficulty of predicting exchange rates (ROSSI 2013) makes clear that volatile expectations can lead to wild swings which can lead to large collateral damages especially if the exchange rate deviates for longer time from levels that seem appropriate from the perspective of the purchasing power parity.

STÜTZEL's reasons for objecting to an appreciation of the German mark in 1969 and his recommendation that Germany should not take a position he referred to as monetary nationalism is interesting especially if one considers the current situation in Europe. STÜTZEL's reasoning is remarkable as he thinks that monetary nationalism is not only detrimental when it used to carry out an inflationary policy – he likewise repudiates that – but also when it is used to carry out a deflationary policy. It cannot be denied that this is similar to the European discussion on stability with Germany in the hawkish camp demanding a strict stability orientation from its European partners without conceding that it might have violated the inflation target from below and that the countries should meet in an intermediate field where Germany accepts “so much internal price increases as it just has to if it does not want to change the parity and at the same time export so much stability as is just acceptable so that the export of deflation does not lead to mass unemployment in other countries”. In the current monetary situation in Europe STÜTZEL might state conclusions that would still unsettle some members of the “stability camp”.

One final remark in this respect: in 1976 STÜTZEL contested a seat in the German parliament for the FDP. A booklet that was produced during the election campaign contained some questions from citizens. One question was: “Do we have to reconstruct Italy and England?” And STÜTZEL answered (my translation):

“The English and the Italians are our partners within the EC. In the same way as tax money from Northrhine-Westfalia helps people in the Bavarian Forest the countries within Europe have to stick together. As industrial nation we have considerable benefits from the large European market – let's also bear our burden!

We form a family; we want it to become a political action group. But within a family one does not about actions of reconstruction, but about solidarity. According to the old proverb: where the family begins, the calculation ends. But building a family also means to work together in the same spirit and to plead for the same aims.”¹⁷

¹⁷ In the original: „Engländer und Italiener sind unsere Partner innerhalb der EG. Und so wie aus nordrhein-westfälischen Steuergeldern denen im Bayrischen Wald geholfen wird, müssen auch innerhalb Europas die Länder zusammenhalten. Wir haben als Industrienationen vom großen europäischen Markt ganz erhebliche Vorteile – tragen wir auch die Lasten! Wir bilden eine Familie; wir wollen, daß eine politische Aktionsgemeinschaft daraus wird. Innerhalb einer Familie aber spricht man nicht von Sanierungsaktionen, sondern von Solidarität. Gemäß dem alten Spruch: wo die Familie anfängt, da hört die Rechenhaftigkeit auf. Eine Familie bilden, das heißt allerdings auch, im gleichen Geiste zusammenwirken und sich für gleiche Ziele einzusetzen.“

Appendix: Additional information on the German Council of Economic Experts¹⁸

The following is a list of the Council's individual tasks according to its legal mandate:

- Analysing the current economic situation and its likely development.
- Examining ways and means of ensuring steady and adequate growth within the framework of the free market-economy system, whilst simultaneously maintaining high employment, price stability and a foreign trade equilibrium.
- While taking into account the accumulation and distribution of earnings and capital.
- Pointing out the causes of current and potential conflicts of macroeconomic demand and supply.
- Pointing out undesirable developments and examining ways and means of avoiding or eliminating these without suggesting specific economic or socio-economic measures.

In line with its legal mandate, the Council compiles and publishes an Annual Economic Report which is released in mid-November. In order to assess particular current problems and depending on the mandate issued by the government, the Council also prepares ad-hoc Special Reports. Since 2005, the Council has also been releasing Occasional Reports on selected topics upon the request of the Federal Government. Since 2014, the Council has additionally published annual economic forecast updates in spring.

Since 1 August 2019 the German Council of Economic Experts has also been appointed as the National Productivity Board (NPB) of Germany. The basis of the NPBs is a recommendation issued by the Council of the European Union on 20 September 2016. The NPBs shall analyse developments in the field of productivity and competitiveness. This includes diagnoses of the long-term drivers of economic development, the conditions for increasing productivity and competitiveness, for example through the promotion of innovation, research and development, education, skills and training, and the capacity to attract investment, enterprises and human capital. A broad consultation process at national level and a regular exchange and intensive cooperation at European level should feed into the analysis. The German Council of Economic Experts has been addressing the issues of productivity and competitiveness in its annual reports since it was founded, and will give an additional analytical focus to these issues starting with the annual report 2019/20.

The Council of Economic Experts consists of five members who are specialists in the field of economic theory and economic policy. They are appointed every five years by the Federal President on the recommendation of the Federal Government. Reappointments are permitted. The Council then selects one of its members as chairperson for three years.

The Council of Economic Experts is supported by the Staff chaired by the secretary general. Furthermore, the Council resorts to the Liaison Office at the Federal Statistical Office in matters of organisation and statistics.

¹⁸ This information is taken from the Council's website: <https://www.sachverstaendigenrat-wirtschaft.de/en/about-us/objectives.html>

References

- COUNCIL OF ECONOMIC EXPERTS** (several years): *Annual report*. Downloadable at <https://www.sachverstaendigenrat-wirtschaft.de/publikationen/jahresgutachten.html>
- FRIEDMAN, M.** (1953): "The Case for Flexible Exchange Rates". In: M. FRIEDMAN: *Essays in Positive Economics*. Chicago: University of Chicago Press, p. 157-203.
- HAYEK, F. A.** (1937 [1999]): Monetary Nationalism and International Stability. In: Kresge, S. (ed.): *The Collected Works of F. A. Hayek*, vol. 6 (Good Money, Part II: The Standard). London: Routledge, p. 37-100.
- REY, H.** (2013): *Dilemma, not Trilemma: The Global Financial Cycle and Monetary Policy Independence*. Federal Reserve Bank of Kansas City Economic Policy Symposium. Downloadable at http://www.helenerey.eu/RP.aspx?pid=Published-Papers_en-GB&aid=147802013_67186463733
- SCHMIDT, J.** (2019): "Warnings of the Euro – Take 2" Paper presented at the 23rd Conference ("The Euro at 20 – Macroeconomic Challenges?") of the Forum for Macroeconomics and Macroeconomic Policies (FMM), Berlin, October 24-26, 2019, (https://www.boeckler.de/pdf/v_2019_10_26_schmidt.pdf)
- STÜTZEL, W.** (1969): *Über einige Währungstheorien: Freie Preise und feste Versprechen, die Eckpfeiler marktwirtschaftlicher Ordnung: Wohin gehören die Währungsrelationen?* (Walter-Eucken-Institut, Vorträge und Aufsätze, vol. 23). Tübingen: Mohr.
- STÜTZEL, W.** (1969a): „Anpassen statt Aufwerten“: VOLKSWIRT-Interview mit Wolfgang Stützel“. *Der Volkswirt*, Nr. 20, 16.05.1969, p. 15-16
- ROSSI, B.** (2013): „Exchange Rate Predictability“. *Journal of Economic Literature*, vol. 11, no. 4, p. 1063-1119.
- STÜTZEL, W.** (1969b): „D-Mark, D-Mark über alles?“ *Die Zeit*, Nr. 41, 10.10.1969, p. 31.
- STÜTZEL, W.** (1978): *Volkswirtschaftliche Saldenmechanik: ein Beitrag zur Geldtheorie* (2nd ed.). Tübingen: Mohr.
- STÜTZEL, W.** (1983): *Über unsere Währungsverhältnisse. Zehn Jahre Floating: Verheißungen und Erfahrungen* (Walter-Eucken-Institut, Vorträge und Aufsätze, vol. 91). Tübingen: Mohr.