The proponents of flexible exchange rates advanced two core hypotheses which can, but need not necessarily be linked. Firstly, Milton Friedman argued that the replacement of the Bretton Woods system by a ‘system’ of floating currencies would reduce exchange rate volatility, by allowing financial markets automatically to interpret the macro-economic signals of national GDP growth, inflation, trade and payments balances with adjustments which would tend towards equilibrium.\(^1\) Secondly, Robert Mundell and others maintained that national monetary policy could be considerably more effective under a system of flexible exchange rates, since it would liberate policy makers from the dilemma of defending both external and internal stability, when either international growth cycles or structural trade asymmetries made this impossible under a system of fixed exchange rates.\(^2\) While subsequent empirical evidence indicates that the first hypothesis was seriously flawed and that the twenty-six years since the end of Bretton Woods has been characterised by severe and disruptive exchange rate volatility,\(^3\) the second hypothesis has at least some measure of plausibility about it, even if this applies more to the Bundesbank than to other agencies of monetary policy. Certainly, the Bundesbank’s operational room for manoeuvre was greatly increased by the suspension of the dollar peg, such that Jürgen von Hagen can talk of the

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\(^3\) In particular, see: Barry Eichengreen, Andrew K. Rose and Charles Wyplosz, ‘Exchange Market Mayhem: the antecedents and aftermath of speculative attacks’, in: *Economic Policy*, No.21, 1995, pp.251–312

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J. Leaman, *The Bundesbank Myth*  
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‘emancipation of monetary policy’ in 1973.\(^4\) This was reflected in a new confidence within the CBC, boosted by its victories over the federal government and the partial discrediting of Keynesianism, a confidence which was initially expressed in the transition to monetary targeting in 1974. While policy hitherto had been driven by improvisation and (sporadic) attempts to manage bank liquidity, announcing a single percentage target for the expansion of narrow money (the ‘central bank money stock’) was deemed less of a hostage to fortune than in the reconstruction period when high rates of GDP growth were accompanied by high and unpredictable rates of growth for both narrow and broad money. As well as being more feasible, the CBC perceived a political value in a specific target, making it ‘easier to withstand political pressure’ and ‘signalling to the public ....the intention of not allowing monetary growth to get out of control’.\(^5\)

At the same time, while 1973 may have marked a temporary resolution to the crisis of exchange rate speculation and management, it also signalled the transition to an extended period of global disequilibrium in which the underlying asymmetries of the Bretton Woods crisis actually increased – contrary to expectations – with corresponding shifts in the balance of power within the global economy. Thus, within the industrialised ‘North’ the economies with higher levels of productivity and trade growth, higher investment ratios and a relative intensity of research and development (Germany and Japan) tended towards structural surpluses, while less successful economies with lower investment ratios and lower productivity growth (Britain) tended towards structural deficits. Similar asymmetries emerged in relations between developed and the majority of developing countries. Apart from oil, the relationship between high grade exports from the industrialised North and the primary and semi-finished goods of the developing South has consistently favoured the North since the Second World War; the falling terms of trade of developing countries mean that larger volumes of coffee, cocoa, copper or other primary goods have to be traded to finance the purchase of the same volume of imported finished goods. The leverage of both German private economic actors and German political agencies, like the Bundesbank, was thus increased vis-à-vis both other OECD countries and less developed countries. This new hierarchy of global power relations was

\(^4\) Jürgen von Hagen, ‘A New Approach to Monetary Policy’ (1971–8), op.cit. 411ff

\(^5\) von Hagen, ibid. p.425