

## 'The Dollar and the European Monetary System', from Europe (2-3 February 1981)

**Caption:** In his editorial of 2-3 February 1981, Emanuele Gazzo, Director-General of Agence Europe, considers the conditions required for the smooth operation of the EMS in connection with the dollar and of speculative operations.

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**URL:** [http://www.cvce.eu/obj/the\\_dollar\\_and\\_the\\_european\\_monetary\\_system\\_from\\_europe\\_2\\_3\\_february\\_1981-en-e5202b54-2d5e-43f5-aded-d49e5f30168a.html](http://www.cvce.eu/obj/the_dollar_and_the_european_monetary_system_from_europe_2_3_february_1981-en-e5202b54-2d5e-43f5-aded-d49e5f30168a.html)

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## The Dollar and the European Monetary System

As happens whenever there is any upheaval on the currency markets, the EMS has once again come into direct line of fire, with the usual platitudes and criticisms being heard. Last week there were persistent rumours about “realigning” bilateral exchange rates because of the pressure on the German mark, which was being sold in exchange not for other EMS currencies, but for dollars. These rumours were denied, and speculators are starting this week ready to finalise their transactions. Calm has returned to the markets, helped by the downward trend in the US prime rate, and an increase in the Swiss discount rate.

We should point out a number of facts which are all too often overlooked:

1. The EMS is not a system of fixed exchange rates. Its aim is merely to “limit” excessive fluctuations which are not justified by the economic situation between the currencies which make up the system. To do this, it provides the monetary authorities with a series of indicators and (important) methods of interventions, at the same time binding them to certain obligations.

2. This means that there may be adjustments in exchange rates provided there is economic justification (and no undue pressure caused by external disorder). Under the system such adjustments are perfectly normal. There have been adjustments of this kind but substantially fewer than might have been feared, and the system has remained intact throughout.

3. Stability in the rates of exchange between the EMS currencies — very important since more than half the EMS countries’ foreign trade is transacted within the system — depends in the long term on the member countries’ pursuing consistent or mutually “compatible” economic and monetary policies. In other words differentials in key indicators (inflation, interest rates, industrial production, money expansion) must be kept to a minimum. If this consistency — whether it be achieved by “cooperation” or constraints agreed jointly — is lacking, there can of course be no stability. An important conclusion to be drawn from this is that if there is any “non-speculative” tension within the EMS, it is not due to the system itself, nor to any error in planning, but rather to the fact that the conditions vital to the smooth running of the system are not right. In other words, other is no stopping halfway. The system must run its full course. This is in fact the thrust of what Roy Jenkins said when speaking to European journalists in Rome last October.

4. The present situation of monetary markets is determined more by the performance of the dollar than by inflation or interest rate differentials within the Community. In recent months the dollar’s performance has been determined more than anything by high interest rates. A new factor has come on the scene, namely confidence in the dollar, and the tension within the EMS is born of the dollar’s increased strength. Strange as it is, one of the objections made to the EMS at the outset was that weak currencies would be dragged upwards by too strong a German mark. Today, Bundesbank sources (who have never been very fond of the EMS) are complaining that the mark is “caught in the trap of the EMS” and has been “dragged down”; by the weakest currencies.

Paradoxically, the truth is that the interest rate differential counts for more today than that of the inflation rate and the German mark has fallen victim to this more than other currencies. The result is that the mark is strong within and weak without as opposed to the dollar, which is weak within and strong without.

One might conclude from this that it is high time the relationship between the EMS and the dollar was sorted out. But we must not be misled by appearances. It is true that a more expensive dollar increases the oil bill, but at the same time, everyone knows it boosts oil producers’ revenue and deters them from introducing new increases, all the more so as a rising oil bill is the most powerful way of curbing consumption...

Emanuele Gazzo