

'Now it is up to Europe' from The Financial Times (6 May 1971)

Caption: On 6 May 1971, a few days before the German Government's decision to float the mark, the British economic and financial daily newspaper The Financial Times analyses the reaction of the various countries to the international monetary crisis.

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THURSDAY MAY 6 1971

Now it is up to Europe

WITH THE U.S. Administration determined to regard the American balance of payments deficit with "benign neglect," a major currency crisis was inevitable sooner or later. The events of the past three days have demonstrated once again how markets these days tend to wait for no man. The first rush into D-marks some weeks ago was not just a flurry in a period of calm, but a dress rehearsal. Some remarks by Herr Schiller followed this week by the publication of the joint report of the chief German economic institutes advocating a float or a revaluation of the D-mark were enough to open the flood gates.

Possibilities

After taking in \$1,000m. in 40 minutes or so of dealings yesterday morning the German Bundesbank withdrew its support for the dollar and closed the foreign exchange markets. A number of other European central banks were quickly forced to follow. Only Paris and London remained islands of comparative calm. Some money came into both these centres, but the amounts were not very large. Clearly there is no widespread belief that the British and the French would follow if the Germans and possibly some other European Governments decided one way or another to adjust their parity against the dollar.

The Germans will not take a decision before to-morrow, when the Cabinet meets. There are theoretically three possibilities: the imposition of exchange controls, a revaluation to a new parity or a float which could well be prolonged. Either of the last two could, of course, be combined with the first. The trouble about exchange controls is that they well might not work, apart from being a fundamental departure from German post-war economic thinking and practice. Even if by some chance they could be made effective in Germany they would not solve the dollar problem. As long as the massive dollar outflow continues speculative money would soon flood to the central bank of another revaluation candidate.

As regards revaluation or an upward float, the pressures on the German Cabinet go both

ways. A change in the D-mark parity would make it easier to contain inflation. On the other hand, some German industries would be hard put to it to maintain competitiveness and profitability in world markets if a revaluation were piled on top of sharp wage cost increases. But this economic problem is not the only one which the German Government has to resolve. On the political plane it has to take into account that a change in the parity would be received with open hostility in France.

The French priority is to narrow exchange rate margins within the Community while maintaining the present parity relationships. Sheltered to a large extent by their exchange controls, they were able to keep the market open yesterday in order to make their point.

The Germans thus have not merely to determine what is best in their own immediate national interest but also the extent to which they can carry their Community partners, and in particular France, with them. At the moment prospects of a Franco-German agreement on a joint policy look anything but bright. The current crisis has pointed up the differences between them. It could for that reason make the negotiations for Britain's entry to the Community more difficult. Next week's Brussels meeting could well be overshadowed by the events of this week.

A solution

One sensible interim solution would be a joint Community float against the dollar. Other countries could then join this bloc if they so wished. Britain would be faced with a very awkward politico-economic choice. But at least after a brief adjustment period some order would be restored to foreign exchange markets. We do not live in an ideal world, however, and a more likely outcome is a split between Germany and France, a unilateral decision by Germany with other governments being forced to consider over the week-end how they should react to Germany's action. What the crisis has already demonstrated is that the rest of the world cannot live in a dollar area if the Americans go on pumping out dollars.