

Valéry Giscard d'Estaing, Power and Life

Caption: In his memoirs, former French President, Valéry Giscard d'Estaing, looks back at the chaotic negotiations which led to the implementation of the European monetary system (EMS) and the ECU (European Currency Unit).

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Valéry Giscard d'Estaing, *Power and Life*

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The decision taken by the US monetary authorities in March 1973 to let the dollar float marked the end of the Bretton Woods Agreements which had established the principle of fixed exchange rates and unlimited gold convertibility of the dollar for central banks. Since that date, the international monetary system has been living without rules. Generalised floating of currencies was initially interpreted as a transitional measure that would allow exchange rates to be adjusted in a flexible manner. Since the very beginning of this new period, the question of restoring order to the system has been under discussion. The Group of Twenty, which was formed under the aegis of the International Monetary Fund and in which France played an active role, tried to define a new system based on 'stable but adjustable parities'. The oil crisis of 1973 was to shatter these fragile efforts. And although I was an active proponent at that time of 'stable but adjustable parities', I have to acknowledge today that the global economy would not have been able to come through the crisis of 1974-1981 with fixed exchange rates and that the system would inevitably have collapsed. For those exceptional times, floating exchange rates were the lesser of two evils.

In the world of floating exchange rates, the Europeans have tried to minimise the fluctuations between their own currencies. The benefits of this course of action were obvious, for there could be no hope of maintaining stable currency flows within the Common Market with price levels that floated along with the currencies. There was, therefore, a need to limit the variations between exchange rates in Europe, and to this end the currencies had to float together against external currencies. It was not easy. Speculation was raising the value of the strong currencies — the Deutschmark and the guilder — and diminishing that of the weaker currencies — the Belgian franc, the lira and, sometimes, the French franc, too. The pound sterling was not affected, because Britain had only recently acceded to the European Communities at that point.

We held lengthy discussions on this matter in Brussels at the informal meetings of the Finance Ministers which took place on a quarterly basis at that time to review the progress that still had to be made along the road to monetary union. In 1970, we instructed one of our group, Pierre Werner, who combined the roles of President-in-Office of the Council and Minister of Finance of Luxembourg, to prepare a phased plan for economic and monetary union. His proposals, which were immediately dubbed the Werner Plan, served as a basis for subsequent deliberations on the subject and included, in essence, most of the proposals that have emerged since then.

In his plan, Pierre Werner came to three conclusions: firstly, in order to eliminate the causes of divergences between their currencies, the European countries should pursue convergent economic and monetary policies; secondly, in order to ensure that market pressure did not generate disorderly development, the central banks should engage in coordinated intervention; thirdly, the success of this course of action depended on the banks' willingness to grant each other credit facilities. These three subjects — policy convergence, market intervention and credit facilities — were the motifs which, over the years, inspired the work of the composers who strove to pen the European monetary symphony.

In May 1971, the Bundesbank decided to let the Deutschmark float.

Our first attempt to respond to this new situation was the 'snake' system. The decision to adopt this system was made in the spring of 1972. Since constant differentials had to be maintained between the values of the European currencies, their movement would be like that of a snake, gliding hither and thither within the international monetary environment but always keeping its parallel shape. In order to ensure that a European currency did not burst out of the snakeskin, the central bank of the country whose currency was under threat would have to intervene to keep it within the defined 'band'. Regrettably, this provision only applied to weak currencies, to those that were liable to fall out from the underbelly of the snake. The strong currencies, those reputedly 'good' currencies whose upward pressure was liable to make the snakeskin bulge, were not subject to any such control.

This mechanism was highly technical and rather incomprehensible to the general public. It began to operate

on 21 March 1972 and worked satisfactorily at first.

One year later, in March 1973, the decision to let the dollar float changed the international environment in which the snake moved. It no longer had to remain within bounds fixed in relation to the dollar, it was allowed to float freely in a vacuum.

In the autumn of 1973, the Yom Kippur war triggered the Arab embargo on oil supplies. The rise in the price of petroleum products, followed by those of chemicals and raw materials, generated a wave of global inflation. The French franc, which was not involved in the major currency movements, stood up fairly well. However, because of West Germany's large trade surplus, the Deutschmark was in demand among speculators and increased sharply in value, pulling the snake with it. To prevent the snakeskin from overstretching, it was necessary to increase the value of the franc, which meant selling dollars for francs in order to reduce the supply of the latter on the markets. The Banque de France drew on its currency reserves. We had neither the means nor, to be truthful, any valid reason to follow the rising mark. The drain on our resources had to be stopped.

A decision had to be taken at short notice. Because of the diplomatic importance of such a decision, it was proper to secure the prior approval of the President of the Republic.

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I described the situation and the available options to him: we could continue to intervene in the markets, resorting to international credit in order to replenish our resources, or we could withdraw from the snake system and let the franc float freely.

'If we let the franc float,' President Pompidou asked me, 'what will happen?'

'Not very much, most probably. We shall maintain our parity against the other currencies, but the gap between the franc and the Deutschmark will widen. That will fuel inflationary pressure because of the rising prices of German products on our market.'

'Can we avoid it?' asked the President.

'We can for a certain length of time, but it will be very costly for us. And, ultimately, we shall not be able to prevent an exchange-rate gap between the franc and the Deutschmark.'

'So we have no choice,' President Pompidou said to me. 'We are not going to waste our resources to delay an event that seems inevitable. We must leave the snake. But it is not a good measure to take, because we must eventually coordinate our monetary policy with that of the Germans. At the most recent summit, I saw that they were not very interested in our situation. As soon as currency comes up in discussion, they become entirely self-centred. They like to make their superiority felt. And, of course, from their point of view, they are quite right. How are you going to announce the decision?'

'I shall say that, because of speculative currency movements, France is suspending her participation in the snake system but that she hopes to resume it as soon as circumstances are favourable again.'

'Yes, say that,' President Pompidou recommended, 'and emphasise it. Present our decision as a temporary measure, made inevitable by the pressure of circumstances. But underline our desire to return to the European agreement as soon as possible.'

I left for Paris, where I announced our decision. The monetary snake now lay motionless, its skin lacerated.

After I was elected President, I asked the Minister of Finance, Jean-Pierre Fourcade, to see to it that the franc was gradually restored to its place in the snake.

And indeed the franc re-entered the snake *de facto* in May 1975, and then, on 10 July 1975, we were able to announce the official re-entry of the franc at the same value relative to the Deutschmark as in the spring of 1973.

Unfortunately, the economic situation was still far from stable. Although our external trade had been back in surplus in the first half of 1975, it began to deteriorate in the second half of that year. Under the impact of a recovery plan, which improved the employment situation but had an excessively stimulatory effect on domestic demand, provoking a sudden upsurge in imports of industrial products, a deficit began to develop again, particularly in relation to Germany. The low rate at which prices rose in Germany, whose economy was reacting better than ours to the oil crisis, drove the Deutschmark upwards. The Banque de France had to intervene to limit the size of the gap. Speculators were anticipating a revaluation of the Deutschmark. Our foreign-currency outflow was excessive, and the prospects for restoring equilibrium in the domain of external trade remained bleak for 1976.

But, by this time, the problem no longer lay in the repercussions of the recovery plan but in a global economic downturn. The prices of our imports, particularly of raw materials, were rising faster than those of our exports.

I found myself faced with the same choice that I had outlined to President Pompidou, and I arrived at the same conclusion: we must not exhaust our reserves simply in order to stay within the prescribed exchange-rate margin. On 15 March 1976, the franc was withdrawn from the snake once and for all.

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