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Foreign Exchange by David Goldman

The French franc and the EMS

Germany hopes to stabilize the franc and other European currencies, but makeshift solutions may fail.

The French franc, which stood at 5.5 to the dollar when François Mitterrand took office as French president in May 1981, slid all the way down to 6.26 to the dollar on March 26, despite the previous day's tightening of exchange controls. It will fall a good deal lower.

The question now in currency dealers' minds is by which means the franc will continue to fall: by daily drops in the currency markets, or by a devaluation.

The fate of the franc involves much more than France. Starting in May 1978, then-French President Valéry Giscard d'Estaing and German Chancellor Helmut Schmidt put together the European Monetary System, as a system of fixed exchange rates and as the seed-crystal for a new gold-based international monetary system. The larger aspirations that lay behind the formation of the EMS have obviously not been realized, but the EMS has worked relatively well in stabilizing European parities. The financial forces whose power is concentrated in the City of London and in Venice wish to crack apart the EMS, and a disruptive form of currency controls could follow.

David Sandberg, the chief economist for currency management at Bankers Trust, reported March 19, "We are being told that the French will devalue some time in May. But the French can't wait. The pressure is too great. If the franc devalues 8 to 10 percent, that may not suffice. Half the problem with the franc is the government of François Mitterrand, and as long as he is in office, there will be constant problems with the franc and money fleeing out of France."

What happens to the franc is of paramount importance to West Germany. France consumes between 25 and 30 percent of German exports. If the French economy goes down under the misdirection of the Mitterrand administration, which is de-emphasizing industry in favor of services, then Germany loses an essential export market—during a period of contracting world trade.

German bankers told me the week of March 21 that Germany has a halfway solution. German bankers do not want to continue to support the excesses of the Mitterrand government through continued German support; thus they would like to see the French franc devalued by 8 to 10 percent, but gently, without the turbulence that often accompanies a devaluation on the currency markets. The new support level is one that the Germans think could work for the near future. But German industrialists are confident that the lower inflation rate and higher productivity that prevails in Germany will continue to make German exports cheap in France, despite a devaluation.

However, the strategy of constant franc turmoil envisaged by Bankers Trust's Sandberg goes beyond what the Germans are looking for. Continued devaluations of the franc mean big trouble. Sandberg predicts: "we think that the European Monetary System is fractured irreparably. The Europeans will not have a fixed-currency system much longer."

Sandberg raises the possibility of exchange controls in some European countries to prevent chaos. "Partial exchange controls now exist in France," he said. They could be adopted in the countries with weaker currencies, such as in Denmark, Ireland, and even Italy if there is enough pressure."

The March 22 London *Financial Times* reinforces Sandberg's view by stating that the above list of countries, including Belgium, may have to devalue their currencies soon.

Were half of Europe's countries forced to devalue, following by only two weeks Belgium's 8 percent devaluation of its franc, then the European continent could indeed be beset with significant currency instability. Such a situation could be heightened by the London and Venetian flight-capital specialists. The U.S. Treasury, under the influence of Undersecretary Beryl Sprinkel, has stated that the U.S. will not intervene into currency markets, unless disaster strikes. Instability and capital outflows, in the absence of currency controls, would jeopardize the common strategy of lowering interest rates in Europe, initiated by Schmidt, and currency controls would pose another set of problems.

In that environment, the French franc could fall a long, long way.

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