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THE DOLLAR CRISIS—A FLASH-VIEW OF RECENT PRESSURES

Since the first week of May the American Dollar has come under great pressure. As a result, most European central banks suspended foreign exchange operation. Some of them have resorted to floating rates while others rovaluation of their currencies. Japan has declared that it will not revalue the yen because its holdings of dollars are of the order of $ 6 billion as against the German holdings of $ 16 billion. The U. S. has announced its firm decision not to devalue the dollar or to raise the price of gold. This firm decision should in due course lead to a tapering of the run on the dollar, provided U. S. fiscal and monetary policies are also properly reconstructed.

FACTORS IN THE RECENT CRISIS

There are certain factors connected with the recent crisis. Under the present monetary system the sterling and the dollar are the main key currencies which are kept in reserves by foreign Central Banks. In the post-war years the dollar gained importance as a key currency and most central banks of Europe have been keeping their reserves in dollars. The dollar reserves with foreign central banks are of the order of 16 billion. Besides, individual business men and institutions have also been keeping dollars with them. The following table shows the purchase of dollars by certain countries for the fiscal year ending April 30, 1970:—

TABLE

(In Million of U. S. Dollars)

Purchases					
France	Germany	U.K.	Other countries	Acquisition by sales of gold	Total
346.6	260.0	404.5	252.0	138.7	1401.9

Source : I.M.F. Annual Report, 1970, page 142.

EURO-DOLLARS

Official holdings of Euro-dollars have considerably increased in recent years. In 1969, when the United States incurred an official settlements surplus of $ 2.7 billions (making allowance for official holdings of Euro-dollars, the adjusted figure would be $ 2.2 billion), the U. S. gold increased by about $ 1 billion. The US reserve position in the Fund increased by a similar amount. What is noteworthy is that as against the holdings with central banks of other countries of over 16 billion dollars in their reserves and a substantial amount with individual businessmen etc., the total gold stock of the United States at the end of March 1970 stood at $ 11.9 billion (Source: Ibid, page 20).

With loss of confidence in dollar due to increase in war expenditure and fall in export surplus of US, there was a rush for converting dollars into other currencies. The holders could also demand gold from the US central banks. The US gold reserves were subjected to a severe drain. This led to a rise in the dollar price of gold from the official rate of $ 35 per ounce to $ 40 per ounce, the highest ever rise. There was a rush to convert dollars into marks and they thought that they would gain further if the mark were revalued. In fact, a mark revaluation appeared to be very much on cards.

BRITISH POUND

The British pound was also caught in the rush. A wave of selling brought the rate for sterling down 41 points to 2.4155 dollars. The Bank of Japan and the Japanese Govt. said that they would continue to maintain the existing par value of the yen. Three courses are opened to the German Government: 1. To keep the mark floating and let it find its own rate on the market; 2. Take measures to restrict industrial borrowings abroad; and 3. Revalue the mark upwards.

The West German markets were closed on May 7, 1971. The Paris Foreign Exchange Market opened in confusion, the dollar coming under heavy pressure. In Zurich, unofficial trading restarted on the Foreign Exchange Market and the dollar was quoted below its official parity with the Swiss franc.

On May 6, the Swiss National Bank withdrew from the market after taking in $ 600 million in 90 minutes of heavy speculative trading and closed the market. In Madrid, the Spanish Institute of Foreign Currency suspended official trading in the dollar. But dealings in private banks continued.

The unpopularity of the dollar due to the low interest yields caused Overseas private banks to sell their holdings in Central Banks. This swelled official claims against the US gold stock and weakened general confidence in the American currency.

Another cause is that the US administration laid emphasis on improving the business climate in the country to reduce unemployment. This came into conflict with the external requirements of stabilizing the balance of payments. The most immediate outcome was an official U. S. balance of payments deficit of $1,000 million in 1970 and a shortfall of $5,000 million in the opening months of 1971.

SHAPE OF THE CRISIS

An important problem of the present monetary system is that it revolves around the dollar as the dominating reserve currency.

Another problem is that the great growth of the Euro-dollar Market for expatriate American dollar deposits in Europe has created a pool of about $40,000 million in uncontrolled funds which can immediately cross national frontiers. Such a great flow of funds can wreck domestic policies by European governments to control the supply of money and credit in their economies. In the case of West Germany massive flows of skippy have swamped domestic money markets and frustrated monetary policy efforts to eradicate inflation. Huge American dollars held overseas have deepened the situation. The immediate cause of the crisis is the expectation for a floatation of the German mark.

OBVIOUS SOLUTION

What is the solution for this monetary dilemma? One obvious approach is dollar devaluation which would create a monetary crisis in the other member countries in the IMF desirous of protecting their trade position. This solution may not be feasible at the moment. The international monetary system as recently evolved during the last about 3 years, contains in-built provisions to remedy the situation. A number of new developments have recently taken place in regard to the quantity and the composition of international liquidity. Partly they resulted from deliberate actions particularly directed to adjusting the quantity or to improving the quality of international liquidity. One of these measures comprised the creation of special drawing rights of the value of $ 9.5 billion for the 3-year period 1970-72, of which $3.4 billion were allocated on Jan. 1, 1970 to 104 participant countries. Secondly, there were developments regarding accrual of gold to monetary reserves which entered a new phase at the end of 1969, when agreement was reached on the terms under which the Fund would purchase gold from South Africa. Thirdly, in the field of conditional liquidity, action was taken in Feb. 1970 to increase the quotas for fund members by $ 7.6 billion, raising the size of the Fund to about $ 28.9 billion.

These in-built provisions in the International Monetary System coupled with a reorientation of US economic policy might help to solve the present dollar crisis. The central banks of various countries must also cooperate in stabilizing the dollar as they did in 1968 to help the pound sterling.

EFFECT ON INDIA

Questions are often raised as to the implications of the dollar crisis for India. In fact, India has meticulous exchange control and though there will be indirect effects produced on the prices and direction of exports and imports, appreciable direct effects on Indian economy are not likely. The floating rates in European countries will in some respects make imports into India from them costlier but India will gain as an exporter to some of these countries. The trade with US is expanding and will not consequently be adversely affected.