British memorandum on the future of intra-European payments (15 December 1949)

Caption: On 15 December 1949, the United Kingdom submits to the Secretariat of the Organisation for European Economic Cooperation (OEEC) a memorandum which emphasises the importance of the introduction of a new scheme which will govern the future of intra-European payments.
Source: Archives historiques des Communautés européennes, Florence, Villa Il Poggiolo. Dépôts, DEP. Organisation de coopération et de développement économiques, OECD. European Payments Union/European Monetary Agreement, EPU/EMA. EPU/EMA 1.

URL: http://www.cvce.eu/obj/british_memorandum_on_the_future_of_intra_european_payments_15_december_1949-en-04f98523-70bc-446c-bae9-5d919472866b.html
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Trade and Finance
Director

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THE FUTURE OF INTRA-EUROPEAN PAYMENTS

(Memorandum by the United Kingdom Delegation(1))

It will be necessary for the Organisation for European Economic Co-operation to agree upon the lines of a new Payments Scheme at an early date. The Council decision of the 2nd November 1949 decided " to widen the area of transferability of currencies among the member countries by suitable measures in the next intra-European Payments Scheme"; there is an obvious necessity for the ~~inclusion of some~~ description of the suitable measures on general lines, if not in detail, in the Second Interim Report, or in the supplementary Reports with which E.C.A. must be provided for their work in connexion with the Third Appropriation; the Organisation is committed to a review of the existing scheme by the 15th January 1950; and we have now been asked by Mr. Bissell to give urgent consideration to his proposals.

2. ~~The present agreement~~ lasts nominally until the 30th June~~, 1950; but it~~ has already become obsolete. The devaluation of most of the European currencies, the introduction of measures for liberalising intra-European trade, and the continued economic progress in a number of countries since 1st July, 1949 have altered the whole background; and some of the principal objections which were raised during the period of negotiation such as the unreliability of forecasts, have already been justified by the results obtained during the first five months of its operation .

3. As it is obvious that some change must be effected in a system where the calculations have become impossible, and the incentives are wrong, in that it does not discourage creditors and debtors from maintaining

(1) This Memo was submitted by the U.K. Delegation to the Secretariat on 15th December, 1949.

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a state of unbalance, it seems opportune to look for a system which will at least move in the direction of post-E.R.P. conditions when there will be no E.R.P. dollars and no counterpart funds, and European trade will not be financed by drawing rights in the form of grants.

4. A new scheme of a much simpler kind is needed in which financial facilities in Europe are not directly linked with E.C.A. dollars; but E.C.A. dollars allocated to participating countries in the division of aid can be firmly allotted, subject always to the overriding control of E.C.A. Such a scheme must also provide for freer transferability of European currencies and thus form the natural counterpart to the measures taken to liberalise trade in Europe; and, together with any progress made in forming regional groups, it would constitute a most practical contribution to the integration of Europe.

5. Therefore the main requirements of the new scheme seem to be the following :-

(a) It should be as simple as possible and should restore some of the normal incentives which are so obviously missing from the present system, e.g.:

  (i) to the debtor to improve his position and not rely always on having deficits made good with no obligation on his part;

  (ii) to the creditor who, without restricting the flow of goods, would import as freely as possible from his European debtors.

(b) To achieve this reformation we should substitute credits or loans for grants; and creditors should no longer run the risk of losing dollar aid if the credits granted are not taken up or spent in other countries. Thus an objectionable feature of the present scheme, which had the effect of making a surplus an objective which must be achieved and interfering with the pattern of trade, would be removed.

(c) The credits granted should be enough to cover any reasonable swing of payments in either direction. They would not be directly linked to E.R.P. dollars, but would be granted in national currencies against the broad background of dollar aid and in fulfilment of the pledges of European Cooperation. Most participating countries will not be able with any certainty to know whether they are going to be debtors or creditors and reciprocal credits are therefore essential. The return to this more normal system of financing would make it unnecessary to attempt to forecast with any accuracy the surplus or deficit of each country with each of the others for a period ahead. This has been found impossible in practice and will be even more impossible under conditions of freer trade and payments. The fixing of limits for such reciprocal credits should be based preferably on some standard of past experience, e.g. the volumes of trade in the preceding year.

(d) The scheme must be multilateral and not bilateral, which means that any country must be able to use a surplus in its current payments with a second country to offset a deficit in its current payments with a third country.

(e) Free transferability of European currencies can only be maintained in present conditions of gold and dollar shortage insofar as the scheme provides adequate scope for free exchanges of goods and services without loss of gold or dollars. No country can be expected to maintain for long free imports or allow transfers of its currency to other countries when it is losing gold. If, therefore, the scheme is to facilitate the liberalisation of trade, it must, so far as possible, reduce to a minimum the risk of gold payments, so that they become the exception and not the rule.

(f) Gold and dollar payments in Europe cannot be entirely excluded because no country can be expected to extend unlimited credit. In the last resort we must be prepared to see gold move, (provided it is the last resort). But before this point is reached it is desirable for the creditors and debtors concerned to see whether balance cannot be restored in any way. If this cannot be achieved by increased imports by the creditors, devaluation of currency or internal deflation by the debtors or the converse by the creditors (such measures, of course, take time to put into effect), or restriction of imports by the debtor must be considered. It has been clear that, in such circumstances, where bilateral arrangements have been in force, a debtor will restrict its imports, when measures by the creditor are of no avail, and will discriminate in regard to a particular country to which it is losing, or is in danger of losing, gold and restrict transfers of its currency thereto. This was recognised in the Council's decisions relating to the liberalisation of trade. There will be similar reactions in any multilateral scheme when the debtor countries can only acquire a scarce currency by dipping into their reserves of gold or dollars. Unless the creditor can remedy the position, debtors may be expected in most cases to discriminate by import restrictions against the scarce currency in preference to devaluation or deflationary measures which would lead to a reduction in imports over a much wider field. This would be a retrograde step in view of the progress in liberalising trade, and underlines the need for adequate credit facilities.

(g) It must be recognised that there will be difficulties in fitting into a scheme of this kind countries who are persistent creditors or debtors :-

(i) In considering the case of the creditors with surpluses in Europe exceeding their dollar deficits in the existing scheme special allocations of dollar aid were proposed as a compensation for the greater extension of credit in Europe. But this dollar aid does reduce the total amount available to the other O.E.E.C. countries who are in great need of it. It cannot therefore be recommended unless the creditors countries have taken steps to encourage imports from their European partners to the maximum possible extent and have granted credits on an adequate scale.

(ii) Where countries are persistent debtors and have inadequate gold reserves and heavy commitments for reconstructions, it is difficult to expect their European creditors to grant unlimited credit. Here again, there may be a case for special allocations of dollar aid to be used in European settlements after credits have been exhausted, but the conditions on which they should be made need further careful consideration.

6. The two central features of any scheme must therefore be willingness of the participating countries to grant credits in some form for the benefit of other participating countries who may become their debtors, and provisions to ensure that the debtors can use the credits granted to cover current payments in any country associated with the scheme. There are several different ways in which these two features can be combined. For instance :-

(a) A currency pool making use of a new monetary unit;

(b) a currency pool making use of members' currencies;

(c) an arrangement by which European Central Banks should extend global credit margins; or

(d) an arrangement whereby they establish reciprocal credit margins on a bilateral basis with some provision for the transferability of currencies or compensations.

There is little practical difference, though some important psychological differences, between (a) and (b). The main practical difference is that, under (b), no new monetary unit of account is used and the right of each member to borrow and its obligation to lend are expressed in its own currency, whereas under (a) a monetary unit is used which automatically provides an exchange guarantee, especially designed for the O.E.E.C. members. In regard to (c) and (d), there would be less supervision from the centre and less attraction from an O.E.E.C. point of view. There are, of course, a number of technical objections of different weight to all the schemes and while it would not be right to reject any of the schemes as substitutes for the present one the U.K. Delegation is of opinion that, of all the alternatives, there is a clear advantage in selecting the first, which we might call for present purposes the O.E.E.C. Currency Pool, with its new monetary unit of account.

7. Before considering the main provisions of an O.E.E.C. currency pool, we must have a clear idea of what its position will be in the European payments system and how it will function. In recommending the introduction of such a system, the U.K. Delegation would not advocate the disturbance of the existing payments agreements. There is no point in overturning a system which in many cases has established generous credit margins without recourse to settlements in gold. As at present, the bulk of Intra-European trade will be financed by the provision of European currencies under these agreements, which are necessary to formalise other monetary arrangements, including facilities for financing trade with the widespread multilateral system of the Sterling Area, the Sterling Transferable Account Area, and the Monetary Areas of other participating countries with territories overseas. The Currency Pool would therefore not be used as an automatic means of settlement of all intra-European payments, but as an additional means of payment to be employed after the existing resources have been fully used. Thus, in a way, it would act as a substitute for gold at a point where existing resources would be inadequate but would still introduce transferability in Europe. While it is true that gold must remain the final means of settlement, it would succeed in pushing off that settlement to a point where it could more easily be avoided.

8. Here it may be appropriate to say that where any scheme of this kind is introduced to supplement the Intra-European payments system, it will be the intention of the U.K. Government to assist, as far as it can with the facilities provided by sterling, which it is hoped can play an important part as a means of settlement in any multilateral system which is likely to develop in future. The use of sterling at present takes different forms; in

(a) the sterling Area, in which there are no exchange restrictions at all;

(b) the Transferable Account Area, in which sterling may be freely used for current transactions under the supervision of the monetary authorities of the countries concerned; and

(c) the area of administrative transferability, that is, the countries outside the Sterling Area between which we allow sterling to be used in special cases, subject to the approval of the Bank of England.

All countries participating in the scheme would naturally have the facilities provided under (a) and a number may have the facilities under (b) and (c). The possibility of using such facilities to the fullest extent possible is under constant consideration.

9. As mentioned before, the setting up of an O.E.E.C. Currency Pool would appear to be an important step towards European integration. It would not, however, be necessary or desirable to make such arrangement dependent upon the creation of some special new institution. It is to be hoped that such a scheme could be run by a body which either forms part of, or acts under the supervision of, O.E.E.C., with the Bank of International Settlements as the day to day agent. There is no doubt that it will require constant supervision, but in a way which could be successfully handled by existing institutions.

10. As regards the provisions of the proposed O.E.E.C. Currency Pool, the main ones would be on the following lines:-

(a) a new unit of account would be constituted having a value fixed in terms of dollars with corresponding rates of exchange for each European currency; and each member would keep an account with the Pool in that denomination;

(b) each member would undertake to accept this unit of account in exchange for its own currency up to a certain limit or quota;

(c) each member would be entitled to borrow this unit of account up to a certain limit, not necessarily the same limit as in (b); and to use it to acquire the currency of other members for the purpose of making current payments to them.

(d) the quotas thus represent the limits within which every member is required to lend and is entitled to borrow;

(e) where these limits are exceeded, gold would become payable, but it can be provided that for a given sum in excess of the prescribed limit only a fraction say 30%, shall be payable or receivable in gold and that for a further given sum, some larger fraction, say 60% shall be payable. By such means ample warning would be given before the final limit is overstepped and 100% gold becomes payable, giving time for the necessary remedial measures;

(f) nothing in the foregoing need prevent a member from voluntarily raising the limit for its holding of the units of account after they had exceeded a certain percentage of its quota; the Pool could also allow a member to overdraw beyond its borrowing quota in suitable cases;

(g) each member would be obliged to sell units of account to the Pool against gold on a request from the Pool. The gold acquired by the Pool under (e) would be used to reduce the balance of the units of account of the member whose holding had passed the prescribed limits. If such a member with excess holdings of units were himself to be in need of another member's currency, he would have to contribute gold in the appropriate proportions, i.e. the same proportion as his debtors use to acquire his currency unless the "other" member's currency itself calls for a different scale of gold payments; in that event the Pool would use that gold to purchase units from the "other" member.

11. These few provisions give some idea of the shape of such a scheme and it is obvious that a good deal of thought will have to be given to it before it can be produced in workable form. Among the difficulties will be the adoption of measures which will effectively prevent the excessive demand for one currency; and this and other features of the scheme will require careful supervision.

12. There remains the question of what part E.C.A. dollars will play in any such scheme :-

(a) It has already been pointed out that adequate credits in national currencies should be made available to the O.E.E.C. Currency Pool and they should be sufficient to cover all normal fluctuations in current payments between the participating countries (with a reasonable margin for contingencies which are likely to arise in this transactional period). This area of operations does not require an injection of E.C.A. dollars.

(b) The credits referred to in (a) cannot, however, be expected to cover a fundamental lack of balance and where this occurs, the system cannot function without special assistance and a need for employing E.C.A. dollars does arise. This can be done in several ways, but there seems to be only one satisfactory way to cater for the extreme creditor and debtor positions referred to in paragraph 5 (g). This would be for E.C.A. to allocate in advance a specified sum in dollars which will be held by the Currency Pool as a means of acquiring the currencies of the extreme creditors and of supporting the granting of overdraft facilities to the extreme debtors. The method of assessing these special allotments and the corresponding sums in national currencies will have to be carefully considered.

(c) In all cases not covered by (b) E.C.A. should be asked to consider whether any country, which is obliged to make fractional gold payments, can have the option of using E.C.A. dollars out of its allocation under the division of aid as a substitute for gold or dollars from its reserves (which may not be available).

To sum up, therefore, payments in E.C.A. dollars should be introduced only through the Currency Pool and should have their origin in pre-determined allotments, so that all participating countries know precisely where they stand before the operations for an accounting period commence. We should try to avoid anything like an unallocated pool of dollars from which payments are made for reimbursing creditors or debtors ex post facto for credits granted over the limit or gold payments. Such a method reintroduces the wrong kind of incentives.

13. In conclusion, it seems possible by introducing a system of this kind to have a greater measure of transferability of European currencies than has been the case since the European Recovery Programme started; and that this system will be an essential counterpart of a successful

policy of liberalising intra-European trade. But such a system will break down under present conditions if the quotas (signifying the credits available) are inadequate. While the introduction of a graduated system of gold payments will act as a shock absorber when the aforementioned quotas have been or are on the way to being exhausted, it is to be hoped that the system can be so designed that these warnings will provide an opportunity for avoiding a situation in which European currencies can only be acquired by settling as to 100% in gold. This would inevitably lead to the state of affairs which was threatening to restrict European trade in 1947, and while the introduction of the gold point is necessary to prevent excessive overdrawing, it should be used temperately. Under this O.E.E.C Currency Pool all participating countries would be similarly placed towards any country whose holding of the monetary units of account exceeds its quota; and if discussions and administrative checks do not lead to measures which alleviate the situation, it will be impossible for the Currency Pool to continue to deal in that currency and the members must be free to discriminate against it. If such situations, which it is hoped will not arise, cannot be handled in this way, the system will break down. None the less, this is not a criticism of the system itself, which seems to the U.K. Delegation to provide the best method of securing transferability of European currencies at the present time. These conditions would be equally upsetting under any system with the same objectives and we must guard against them. Finally, although an injection of E.C.A. dollars seems essential to cover extreme creditor and debtor positions their use should be planned in such a way that the transferable system does not collapse at the end of the E.R.P. period.

14. It is not opportune to go into any more detail about the administrative supervision of the scheme. The first task is to agree the general principles so that a suitable contribution can be made to the Second Interim Report and the basis for technical and detailed discussions can be provided. But it is suggested that if such a scheme is adopted, it should cover a period of two years, or until the end of the E.R.P. period, and should be drafted in such a way that it could be continued thereafter if it were found to be desirable.

15. The substantive part of this memorandum was prepared before the receipt of Mr. Bissell's paper on the subject and it does not attempt to deal with specific points raised in that paper. The U.K. Delegation thought, however, that it might be helpful to the discussions which are going to take place, if some account were given of the reasons which led them to conclusions similar to those contained in Mr. Bissell's paper.

PARIS. 14th December, 1949.