

First Annual Report of the European Payments Union (1951)

Caption: In 1951, the European Payments Union (EPU) publishes its first annual report setting out the main activities of the organisation since it was created.

Source: European Payments Union. First Annual Report of the Managing Board. 1st-8th. 1950/51-1958. Paris: OEEC, 1951. 42 p. p. 21-41.

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URL: http://www.cvce.eu/obj/first_annual_report_of_the_european_payments_union_1951-en-e3c4ed64-cb69-404a-abea-9bd291ad2b34.html

Publication date: 14/05/2013

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[...]

The main events in the financial year

31. The European Payments Union was conceived at a time when the European economy, fortified by the generous assistance provided by the United States, was beginning to recover from the havoc and disruption caused by the war and had already shown considerable improvement. Prices had become more or less stable and inflation had been checked; in certain countries there had even been a slight recession. The Union came into being just when this reconstruction effort, so painfully achieved, had been given a severe jolt by the Korean war. The resulting deterioration in the international situation, the increase in the price of raw materials and the introduction everywhere of enlarged defence programmes changed the economic conditions in which the Union was expected to operate. There is no doubt that the Union would in any event have had to deal with some difficult problems and it is therefore not surprising that, in such changed conditions, it has been faced with a series of crises during its first year. So far it has been able to withstand the strains put upon it.

This section is written entirely in terms of the position of individual members within the Union. The graphs in the Annex showing the changing position of members not only during the last year, but also since October 1948 when the first Intra European Payments Agreement was signed, may be of assistance.

A. The German Crisis of October 1950 and February 1951

32. In October 1950, at its first meeting, the Managing Board was faced with the problem raised by the considerable deficit incurred by Germany vis-à-vis the Union during the first three months of operations. This deficit amounted to 173,4 million units of account, i.e. approximately 54% of the quota allotted to Germany, and appeared to be increasing at a very rapid rate. At the request of the German Government two independent experts, Messrs. Per Jacobsson and Alec Caincross visited Germany to study the position and to report to the Board on the prospects of the deficit being reversed. At the end of October, Germany's net cumulative deficit amounted to 301,5 million units of account; in respect of about 170 million, this represented a deficit on commercial and invisible transactions and by amortization of debt; the remaining 130 million dollars of the deficit were explained by changed conditions of payment resulting in part from rumours of sterling revaluation. The Experts considered that the trade deficit would continue during the following months and would probably amount to another 170 million dollars for the period 1st November 1950 to the end of January 1951. They thought, however, that, in view of the continued improvement in German production and exports, there was a reasonable hope that equilibrium would be established by the Spring of 1951 and, thereafter, a surplus gradually built up, provided a number of measures were taken in the field of monetary and fiscal policy.

33. On the basis of this study, the Board suggested that the Council should invite the German Government to prepare a general programme of measures designed to restore equilibrium. The Board also recommended that certain measures in connection with commercial policy should be taken by the other Member countries, involving, in particular, the inclusion in the liberalization lists of products of interest to Germany.

34. The German Government presented such a programme and on the basis of it the Board proposed that provision should be made to cover a deficit of 180 million units of account in excess of the German quota. It proposed that a special credit of 120 million units of account should be granted to Germany by the Union, to be repayable in equal monthly instalments during the six months ending on 31st October 1951; whilst Germany, for her part, should settle in gold a third part of any deficit within the limits of 180 million units of account above the quota. These proposals by the Managing Board were approved by the Council in its Decisions of 13th December, 1950. From this time onwards the Managing Board, in accordance with a mandate from the Council, kept the German situation under continual review.

35. At first the development of the German position did not seriously belie the estimates; German exports

continued to rise and the overall position continued to improve. However, in February the deficit with E.P.U. began to increase at an alarming rate, so that it seemed likely that the special credit would be exhausted by the end of March and before equilibrium in Germany's situation had been achieved. This development was undoubtedly due in large part to a worsening of the international situation at that time. The volume of internal credit outstanding showed no decline and the tendency to convert money into goods was reflected by a rise in the daily rate of import licenses granted in the liberalized sector. The introduction of the corrective measures was taking longer than expected and would take still further time to have an effect. Confronted with this situation, the German Government decided, on 19th February, that liberalization measures should be suspended, and accordingly invoked Article 3 of the Code of Liberalization. After a careful enquiry into the situation the Board reached the conclusion that Germany should not, at least for some time, assume additional payment commitments and consequently the measures taken to suspend the issue of import licenses in the liberalized sector should be extended to the non-liberalized sector. Moreover, Germany should reduce as far as possible the amount of licenses already granted, in order to release resources which could be devoted to a limited amount of imports from countries whose position in the Union was endangered by the suspension of importing by Germany.

36. In addition, the Board recommended that the German Government should expedite the implementation of measures concerning the monetary and fiscal policy which it had undertaken to introduce when the special credit was granted. Finally, the Board proposed a number of administrative measures concerning the issue of licenses, exchange control, transit trade, export promotion, monetary and fiscal policy, the capital market, and the direct control of investment.

37. From this point onwards the German position began to improve, and on 24th April 1951 the Managing Board recommended that the German Government, proceeding cautiously, should resume the licensing of imports in order that no interruption of trade should occur in the months to come. In May 1951 the Board informed the Council that in its view it was no longer desirable to recommend to the German Government, month by month, what should be the amount of its imports from the E.P.U. area. The Managing Board considered that Germany would be in a position to pay for imports from the E.P.U. area an amount corresponding to a monthly rate of 170 million dollars, as compared with a monthly rate of about \$220 million before suspension. On the basis of this report, the Council made recommendations dealing with the commercial relations between Germany and the other members.

38. By the end of May the German position had so far improved that the whole of the special credit used had been repaid and Germany had repurchased the gold paid by her in connection with the use of the special credit. In accordance with instructions from the Council, the Board has since continued to review the external financial position of Germany to see whether any change should be made in the proposed monthly allotment of imports from the E.P.U. area of \$170 million a month. The Board has maintained its opinion that Germany should proceed with caution: the German internal situation still appeared unstable and important changes in Germany's internal requirements were not unlikely; for the present the figure of \$170 million should not be exceeded.

39. Despite the continued uncertainties of the situation the restoration of the German position is a matter for satisfaction to the Organization. Great patience and restraint have been shown by all members, not least by Germany. The Board wishes to record its gratitude to the Federal German authorities for the assistance which they have given during these difficult months. At all times they have been willing to produce all information asked for, and to send officials to discuss the problems with the Board.

B. Payments difficulties in Greece, Austria, Iceland and Turkey

40. Meanwhile, other countries were also faced with difficulties which, in many cases, were accentuated by the restrictions imposed by Germany to re-establish its own position.

i) Greece

41. For 1950-51 Greece had been allotted an initial credit balance of 115 million units of account and its borrowing quota was frozen.

42. After the operations for December 1950 Greece's cumulative deficit with the Union amounted to 70.8 million units of account and approximately 60% of her initial credit balance had already been used. The Managing Board therefore drew the attention of the Greek authorities to the consequences of a premature exhaustion of the initial credit position and requested them to furnish detailed estimates of the way in which they expected Greece's position vis-à-vis the Union to develop during the first six months of 1951.

43. In February, the Board had an opportunity of discussing the whole question with experts from Athens, with particular regard to the estimates of the balance of payments and the Greek import programme. These estimates suggested that, during the year, a deficit might be incurred exceeding by 78 million units of "account Greece's total resources within the Union. The Board informed the Greek Delegation that, in its opinion, the Greek problem was by its nature a long-term problem which could not be settled by financial aid from the resources of the Union. The Board could not recommend any other form of assistance until the proposed import programme had been reconsidered and an effort made to reduce the deficit.

44. After consultation with E.G.A., the Greek authorities prepared a new programme up to the 30th June 1951, and submitted it, with a fresh balance of payments estimate, to the Managing Board in the middle of March, when further discussions took place with the Greek Delegation. The Board considered that the Greek Government's decision to re-impose quantitative restrictions on all its imports from the E.P.U. area was wise and realistic in the circumstances. As a result of this and other measures, the estimated deficit was substantially reduced, and thanks to the authorisation given by E.G.A., \$25.3 million from direct aid were made available for financing Greece's deficit with the Union.

45. At the 30th June 1951, the Greek deficit exceeded the initial balance by 24,3 million of units of account and this excess was covered by the switch of direct aid referred to in the preceding paragraph.

ii) Austria

46. For 1950 51 Austria had been allotted an initial credit balance of 80 million units of account and its quota was frozen.

47. At the end of the first six months of operations, Austria had incurred a net cumulative deficit with the Union of 37.4 million units of account. This was slightly less than 50% of her initial credit balance, but recent indications showed that the monthly deficit was likely to increase well above the average for the previous six months. Consequently, in February 1951, the Managing Board drew the attention of the Austrian Government to this situation and, in view of the size of the Austrian import programme planned for January to June 1951, pointed out that the resources made available to Austria in the Union were in danger of premature exhaustion. It suggested that certain administrative measures should be taken at once if Austria wished to avoid covering entirely in gold any deficit she might incur in excess of her initial balance.

48. In March, following a request for special assistance submitted by Austria, the Board carried out a more detailed examination. The Austrian authorities discussed with the Board measures which might strengthen controls over the issue of import licenses, exchange controls and the control of the Central Bank over credit policy, and also measures to ensure equilibrium in the Budget.

49. In April 1951, the Board had a comprehensive exchange of views with an Austrian Delegation from Vienna on the different measures which the Austrian Government had taken or proposed to take in the near future to establish the internal economic equilibrium of the country and to improve its external position.

50. Following this examination, the Board proposed that the Council should recommend to the Government of the United States that it place at the disposal of Austria, for the months of April, May and June, an amount of special assistance not exceeding 10 million dollars which could be used by Austria, together with

and in equal proportions to its own reserves, to settle deficits exceeding its initial credit balance, on the understanding that Austria would implement fully and energetically the programme and the other measures proposed by it and discussed with the Board.

51. At the end of the financial year Austria had drawn fully on the facilities granted by the E.G.A. and had used \$14.1 million of its own resources to settle its deficit with the Union.

iii) Iceland

52. It appeared in April that Iceland was incurring deficits which would exceed the initial credit balance of \$4 million which had been allotted to it. The E.G.A. had stated its intention to cover to the extent of \$3 million Iceland's deficits for April, May and June 1951, and proposed that Iceland's borrowing quota should be frozen till the end of the current financial year. The funds placed at its disposal by E.G.A. proved exactly sufficient to cover Iceland's deficit in excess of its initial credit balance by the end of June.

iv) Turkey

53. Turkey succeeded in maintaining a credit position with the Union during the first nine months of the financial year. But, during March and April its situation suddenly deteriorated and considerable deficits were incurred. It immediately submitted to the Organization a request for special assistance amounting to \$45 million. The Board considered the Turkish request on two occasions in June 1951, and discussed it with a Turkish Delegation from Ankara.

54. The Board considered that the Turkish request for supplementary assistance for June did not fulfil the requisite conditions to enable the Board to recommend it to the consideration of the Council. In 1950-51, Turkey possessed, in the form of a quota, credit facilities which she might normally have required to meet the temporary fluctuations in her current balance of payments. No serious troubles arose in this respect as the increase in imports due to liberalization was, to a fairly considerable extent, offset by the increase in exports. In order to carry out her investment programme Turkey received as a loan an initial credit position of \$25 million, the amount of which was known at the beginning of the period under review and with the result that the programme should have been adapted to it. The Turkish deficit was, therefore, not the result of chance circumstances but had developed in accordance with its own estimates, and Turkey possessed the means to meet the obligations which she had incurred. While it appreciated the present difficulties, the Board felt bound to note that, in respect of the month of June, these difficulties offered no grounds for recourse to the Special Assistance Fund.

55. The Board noted, however, that the financing of the Turkish programme over the coming months would present a problem. The examination of this aspect of the Turkish problem has been undertaken in the context of the general study of the means for financing the structural deficit positions of Member countries during the new financial year.

C. The position of Portugal

56. While the situation of certain debtor countries of the Union was developing in this manner, the accumulation of surpluses by some other countries was causing the Board concern. Of these countries, Portugal was the only one to reach a critical position before 30th June 1951.

57. In January, the Board had invited a delegation of Portuguese experts to discuss the situation created by the accumulation of surpluses which, by the end of that month, had reached an amount equivalent to about 66% of the Portuguese quota. It drew the particular attention of the Portuguese Government to the following aspects of Portuguese policy which, in the opinion of the Board, seemed likely to maintain and increase this surplus: the policy of restricting internal credit, which created payments difficulties for importers in financing their purchases ; the increase in customs tariffs, which might partly offset the effect of

liberalization; the relatively low level of imports into the overseas territories, whose balance of trade showed a considerable surplus in relation to Member countries; and lastly, in view of the substantial difference between the surpluses on trade and payments account within the Union, the absence of any measures to prevent the flight of European capital into Portugal.

58. After operations for February, Portugal's surplus amounted to 58 million units of account, i.e. 84% of its quota. The Board re-examined the position with a Portuguese Delegation from Lisbon who reported the action they had taken or were proposing to take in accordance with the previous recommendations of the Board. In the light of this examination the Board proposed a number of remedies to be applied by Member countries and Portugal, in order to combat this tendency to accumulate surpluses. In addition, in order to facilitate the settlement of any surplus which Portugal might incur in excess of its quota up to an amount of 25 million units of account the Board proposed that these should be settled to the extent of 50% by gold payments to Portugal and 50% by Portuguese loans to the Union. These proposals were approved by the Council.

59. The Portuguese surplus continued to increase until April, when 96% of the quota had been utilized. Subsequently, Portugal began to incur monthly deficits so that by the end of the financial year it had only exhausted 84.4% of its quota.

D. Monthly examination of the situation of member countries

60. Although the Managing Board is only required by its mandate to act in cases of extreme disequilibria, it considered it wiser not to wait for crises to occur before studying the situation of the various Member countries. In fact, during each ordinary session of the Board, there has been an almost continuous examination of the situation of the Member countries. Where necessary, the Board has sought the assistance of member Governments in its studies and has found them most cooperative; they have provided full information and in many cases have sent delegations to Paris to assist the Board. This co-operation with the representatives of the Governments has been very valuable in the work of the Board.

61. In addition, and under its terms of reference, the Board has also had to study the case of countries which felt unable to implement fully the measures of liberalization adopted by the Organization. On a number of occasions, it gave advice either to Special Restricted Committees or to the Council. It acted thus in the case of Iceland, Norway, Denmark and Germany.

62. Two countries, namely the United Kingdom and France, particularly engaged its attention during these studies on account of their importance in intra European trade.

i) United Kingdom

63. The Managing Board has had several discussions on the position of the United Kingdom in the Union. In particular, careful consideration was given to the problem of the United Kingdom surplus in February and again in May. The reason for these discussions was not because the United Kingdom position in the Union was in any way critical; for although there were substantial surpluses, the use of the high quota of the United Kingdom never at any time exceeded 43% - but because there was some anxiety that the counterpart of these surpluses might give rise to difficulties for debtor countries whose quotas were relatively small.

64. The Board was informed of certain measures which the United Kingdom was taking, the effect of which should be to prevent the surplus with the Union from becoming excessive: the removal of quantitative restrictions against imports from other members of E.P.U. was being carried out as far as possible; the allotment of foreign exchange to residents in the United Kingdom for travelling abroad had been increased; a programme of increased purchases from Member countries of defense materials was being planned; as regards the rest of the sterling area notification had been given to all competent authorities that there was no longer any financial obstacle to increased purchases from the E.P.U. area; and the United Kingdom had agreed that members holding sterling balances could use them freely to settle deficits or that they should be

reduced by instalments if held by creditors of the Union. It was also clear that in the 4th quarter of 1950, when the surplus had been a substantial large, exceptional factors were at work; there had been a substantial amount of forward buying by other members of E.P.U. of sterling area goods and certain speculative movements of funds brought about by rumours of revaluation of sterling. For all these reasons the United Kingdom representative thought that, although surpluses might continue in 1951, they would be on a much reduced scale. Furthermore, whereas in the second half of 1950 the surplus with E.P.U. had been shared equally by the United Kingdom and the rest of the sterling area, the tendency towards the end of that year and in the first quarter of 1951 was to show a much larger proportion of the surplus for the rest of the sterling area than for the United Kingdom. The general conclusion in regard to this development was that other Member countries could themselves influence the position by increasing their exports to the British Dominions and Colonies. The Board accepted these explanations.

65. This forecast has, in fact, proved to be correct up to the end of June. The abnormal factors which were apparent in the last quarter of 1950 have not come into play so much in 1951 except perhaps, to a smaller degree, in April. The check to the upward trend of prices in raw materials from the sterling area and the increased purchases in Europe by the United Kingdom and members of the rest of the sterling area have been having their effect. The net surplus with the Union for the six months to 31st December 1950 was 476 million units of account; and for the six months to 30th June 1951 was 131.5 million units of account.

ii) France

66. The French representative explained to the Board in February 1951 that the creditor position of France could not be considered disquieting for the following reasons:

a) With certain countries in the Union the French balance of trade was traditionally in deficit, and the rise in prices of raw materials could not fail to increase this disequilibrium.

6) The French Government intended to pursue a liberal commercial policy in order to ensure ample supplies for the home market and thus to combat the rise in prices which might result from the rearmament drive. In fact, the French Government had withdrawn the reservations previously made with regard to increasing the liberalization percentage up to 75%; by lowering certain customs tariffs and by granting quotas more generously under bilateral agreements it had encouraged imports into the home country and had extended liberalization measures to additional Overseas Territories.

c) The French Government was prepared to maintain or even, for certain commodities, to increase the volume of imports from Germany and, on the other hand, to restrict certain of its exports in order to assist the Organization in its efforts to help Germany to restore its balance of payments.

d) Lastly, on the financial side, the French exchange control regulations had been considerably relaxed and certain measures could only help to stabilize France's position in the Union (extension of the list of transfers authorized, without any demand for reciprocity; very generous exchange allowance to tourists going abroad; liberalization of foreign assets).

67. The Board recently noted with satisfaction that the estimates made by the French representative were confirmed by the development of the position of France in the Union during the last few months; at 30th June 1951 the net cumulative surplus of France was down to 196,4 million units of account, after having reached a maximum of 272 million at 31st March 1951.

iii) Netherlands

68. In February, the Board made a preliminary examination of the Netherlands. The Board was afterwards informed about the economic programme of the new Netherlands Government and about the measures being taken in implementation of that programme. At the time when the Union completed its first year of

operations the Board was giving further attention to the position of the Netherlands whose deficits with the Union continued to increase.

i) Belgium-Luxembourg Economic Union.

69. In May the Board made a preliminary examination of the increasing surplus of the Belgium Luxembourg Economic Union. At the completion of the Union's first year of operations the Board was giving further consideration to this problem, since it appeared likely that the Belgian quota would rapidly be exhausted.

CONCLUSIONS

70. The previous sections of this report have dealt with the actual operations of the Union and have given an account of the main events during its first financial year. The following comments of a more general nature are submitted in the hope that they may be of interest to the Council and may assist it in considering how best to deal with the problems and difficulties that still lie ahead.

71. The objectives of the contracting parties, when the European Payments Union was established, were, as stated in the preamble to the Agreement:

Considering that such a system of payments must be designed to facilitate to the largest possible measure among the Contracting Parties, the liberalization, on a non-discriminatory basis, of trade and invisible transactions; to assist the Contracting Parties in their efforts to become independent of extraordinary outside assistance; to encourage the Contracting Parties to achieve or maintain a high and stable level of trade and employment, bearing in mind the need for their internal financial stability; and finally, to assist the transition from their present situation to that which will succeed at the termination of the European Recovery Programme by providing them, in particular, both with resources to play in part the role of gold and foreign currency reserves and also with the possibility and incentive, should their position improve, to strengthen their reserves in gold and foreign currencies;

Considering that such a system of payments should permit the maintenance of desirable forms of specialization in trade, while facilitating a return to full multilateral trade, and should at the same time assist a return to the general convertibility of currencies;

But this statement of objectives was concluded by a warning that the maintenance of the internal and external financial equilibrium of the Member countries was an indispensable condition to the operation of this system of payments.

72. Since the European Payments Union came into force, the deterioration in the international situation, the rise in the prices of raw materials and the introduction of programmes for increased armaments have substantially changed the conditions in which the Union was to be operated and provided new factors which may lead to internal and external disequilibrium. It says much for the flexibility and strength of the Union that it has been able to operate with reasonable success for a period of twelve months in such disturbed conditions, and that it has indeed assisted members to weather those conditions.

73. It is obviously impossible to foresee what the course of events will be in the ensuing twelve months. The new factors to which reference has been made cannot yet have had their full effect on the economies of Member countries, and the extent of the disturbance in their internal and external equilibrium is not yet known. Moreover, it is inherent in the structure of the Union that it works more easily at the beginning when its full resources are available, and there must develop an increasing strain on those of its members whose positions are continually either debtor or creditor. It is indeed fortunate that the Union should have been established with its full resources available when the economic storm broke. The Managing Board therefore

feels obliged to draw attention to the possibility that the functioning of the Union may be rendered difficult through causes outside its control. It expresses the hope that the energetic measures which Member countries have pledged themselves to take will allow the operations to be continued and the original objectives to be attainable.

74. But whatever may be developments during the coming year, the Managing Board ventures to state that in its view the European Payments Union has fully justified the confidence placed in it by the United States and all Member governments. It has proved itself to be a satisfactory international mechanism for payments during the transitional period between the European Recovery Programme and the full attainment of convertibility of currencies and a multilateral trade system on a world-wide basis, and will mark an important stage in that difficult journey. Given reasonably stable world conditions there is no reason why the objectives of the contracting parties should not be attained.

75. It appears desirable to examine in some detail whether progress has been made during the year towards the objectives the members had before them when they created the Union. The objectives set out in the preamble to the Agreement may conveniently be divided into three groups:

- a) those having regard to commercial and financial relations between the members;
- b) those having regard to progress of the members towards financial independence ;
- c) those having regard to the transition to world wide commercial and financial relations.

76. The first of the objectives - to facilitate to the largest possible measure among the contracting parties the liberalization on a non-discriminatory basis of trade and invisible transactions has undoubtedly been achieved by the Union.

77. The discrimination, at least on currency grounds, against countries such as Belgium, Switzerland and Germany, which was a disturbing factor in the relationship between the members in the past few years, has been brought to an end. The results of the abolition of this discrimination in visible trade are already striking. For example, Belgian exports to countries which, before E.P.U. was formed, had been obliged to discriminate against Belgian goods for payments reasons, have for the most part increased far more than they have towards countries which had not previously felt obliged to adopt this policy. Moreover, the increased importation of Belgian goods by countries previously discriminating against Belgium has been much greater than the overall increase in imports during the same period; this has indeed occurred in some cases even though there has been some slight decline in imports from the E.P.U. area as a whole. Quite apart from the psychological and even political advantages flowing from the abolition of discrimination, it is clear that there has been a change in the pattern of trade. That change has itself created new problems, but, provided that multilateral non-discriminatory trade between the members can be maintained, the new pattern is probably healthier than the old one.

78. As has been shown earlier in this report, the system of multilateral compensation has worked remarkably well; of about \$3,200 million of monthly bilateral surpluses and deficits incurred during the year, \$2,100 million have been settled by the mechanism of the Union - multilateral compensations or the cumulative principle - leaving \$1,100 million to be settled by credit or gold payments. This has greatly economized the use of resources needed for settlement. The fact that Member countries no longer have any interest in seeking a strict balance in their bilateral payments, and that credit facilities are available within the Union, have together made possible the more liberal trading policies followed during the year by the members. Further, they have certainly contributed to the striking increase in the total volume of this trade. During the nine months from 1st July 1950 to 31st March 1951, the value of this trade has exceeded the value attained during the corresponding nine months of 1949 to 1950, which was already very high, by nearly 30%. The increase in volume is certainly less than this, due to higher prices, but there has clearly been a considerable increase.

79. There can be little doubt that the Union has assisted the contracting parties to achieve and maintain a

high and stable level of trade and employment. It is true that the general situation has itself tended to produce a very high level of activity throughout the world, but it is at least questionable whether the strains of the post Korean world would not have led, in the absence of E.P.U., to a serious dislocation of intra European trade. When E.P.U. was formed, the credit margins provided for in the various bilateral payments agreements were very largely exhausted. The critical positions of some countries which were revealed in the months immediately after the creation of the Union could only too easily have led to bilateral payments difficulties and the suspension of measures of liberalization of trade in the more difficult bilateral relationships. Individual countries have indeed run into difficulties during the period and have been forced either to suspend measures of liberalization, or to advance more slowly towards complete liberalization than they had at one time hoped. None the less, a very high volume of trade has been achieved and maintained to the advantage of the economic stability of all members; and there has probably been a more steady advance than would have been possible without E.P.U. The difficulties have been localized instead of spreading throughout the area: certainly there has been no new discrimination, whereas without E.P.U. the year might well have produced an intensification of discrimination.

80. The handling of the German problem has been described in an earlier part of this report. It is, however, relevant to point out at this stage that without E.P.U. a satisfactory solution of that problem would have been hard to find. It is difficult to believe that multilateral non-discriminatory trade would not have been seriously affected. Necessarily the German crisis has caused loss to many countries and in some cases has aggravated and made more complex very difficult situations. But to date it does not appear that any national or general commercial interests have been permanently damaged, and the common objective and endeavour remains unimpaired. Germany has been able not only to repay the special credit more rapidly than was expected, but has also been able to balance its accounts with E.P.U. at a much higher level than would have been possible had she had to seek a series of bilateral solutions. This will undoubtedly assist Germany to re-establish liberalization more rapidly than might otherwise have been the case.

81. The liberalization of trade and invisible transactions has been accompanied in very many countries by a relaxation of exchange control restrictions generally. It is clear that, in addition to the statutory obligations undertaken by members to liberalize completely certain defined transactions, the administration of the exchange control, both as between members and vis-à-vis non-members, has become progressively more liberal since the formation of E.P.U. While this development is certainly due to many factors, the Managing Board believes that the E.P.U. had a significant part in it.

82. The establishment of the Union has; had a series of beneficial results in matters which, while not of the first importance, none the less a valuable contribution to the restoration of healthy international economic relations. During the difficult years immediately after the war, a very large volume of intra-European indebtedness had been incurred. This existed in many forms and continually gave rise to complex problems. One consequence of the formation of E.P.U. has been to enable substantial repayments, accompanied by general consolidation and funding, of this indebtedness. As has been shown elsewhere, more than a third of the unfounded indebtedness existing at 30th June, 1950, has already been re-paid. For the most part this repayment has tended to facilitate the functioning of the Union rather than increase the strains upon it, but even where old debts have simply been replaced by new ones the process has itself been sane and healthy in that it has introduced order into a hitherto confused field and has thus contributed to the restoration of confidence in intra-European financial arrangements.

83. The formation of the Union has also led to the completion of bilateral agreements providing for payment facilities between settlement dates in E.P.U. even where similar agreements did not exist before. This has certainly assisted the development of trade in some relationships where previously it had been very difficult. Partly in consequence of this, the Union has made possible a considerable reduction of the barter trade still existing in certain relations; and there is a hope that the limited amount still remaining can be abolished during the course of the next year. This will be an important step towards one of the objectives of the Agreement.

84. It is very much more difficult to determine how far the Union has been able to promote progress towards the two other important objectives summarized in paragraph 75, (b) and (c). The crucial question for the

satisfactory operation of the Union, or of another payments system, including a system of full convertibility, is to what extent the member has been able to achieve and maintain internal and external equilibrium. It was hoped that the automatic incentives and checks built into the Agreement, together with the counsel and advice of the Organization to its members, through the various organs established for this purpose, including the Managing Board as well as the other Committees of the Organization, would tend to influence the policy of members and lead them to follow courses of action which would maintain their equilibrium. The experience of the first year in this matter is not without hopeful signs. Assistance or counsel has been given to many members, both debtors and creditors, with a view to averting extreme positions and consequent difficulties; in many of these cases, whether or not because of the intervention of the Organization or of the appreciation by members of their obligations under the Agreement, there has recently been a reversal of the previous tendencies which were working against the achievement of equilibrium; or at least a halt has been called.

85. In judging the success of the members of the Union in achieving general equilibrium, it would be a grave mistake to look solely at the position of members within E.P.U. The fact that a member of E.P.U. is continually in deficit in the Union is not in itself any evidence that the country is, in effect, in disequilibrium. Provided that such a member earns or acquires resources outside E.P.U. which can be used to offset its deficits within E.P.U. the present system can continue to function satisfactorily. In certain cases it may, however, be necessary to devise special techniques to mobilize such earnings of third currencies, and the Board intends to give further consideration to this problem.

86. Such resources brought into the Union to enable debtors to settle their positions in E.P.U. need not necessarily be current earnings. Some use of monetary reserves is quite proper, since such reserves are, inter alia, intended to enable the country to avoid necessarily seeking equilibrium within too short a period. In addition, some members need to import capital for internal investment, and an intensification of international long-term lending to countries which tend to be debtors in E.P.U., whether the funds are European or non-European, is very necessary.

87. The Union was intended to make temporary resources available to give its members time to achieve this general internal and external equilibrium, and the mere fact that many members of the Union have, during the year, made very substantial use of their quotas, is not in itself evidence that the resources of the Union are being used to postpone the adoption of measures designed to achieve the necessary overall equilibrium. On the contrary, the Board has noted with satisfaction the measures that have been taken during the year by various Governments. But it always takes time before the full effects of such measures are felt, generally rather longer than their authors expect, and the Board hopes that where necessary there will be an intensification of such action so that the results can be observed before the resources made available to the country concerned by the Union are exhausted.

88. The Managing Board would not wish to convey the impression to the Council that in its view the sole responsibility for the establishment and maintenance of equilibrium rests with debtor countries. On the contrary, in any multilateral trading system it is the creditors, or those countries which tend to be creditors, which must, by a liberal importing policy, ensure that the equilibrium of the whole is achieved at a high level of trading activity. Since E.P.U. is a regional payments system, it is probable that creditors in E.P.U. will tend to be debtors outside E.P.U. It has never been the intention that E.P.U. should lead to the creation of a closed trading zone and therefore there can be no question of calling on creditors within E.P.U. to seek to balance their position within it artificially, by methods which would violently distort their trade pattern and thus impair their general competitive position. None the less, it remains the responsibility of the creditors in E.P.U. to assist the debtors in E.P.U. by importing as liberally as possible from them and by not seeking large quotas for their exports of non-liberalized goods. The first part of this obligation is already implicit in the Code of Liberalization of the Organization. The Board hopes that the creditors will continue to take all possible measures to import freely, beyond their specific obligations under the Code, agricultural products and manufactured goods from the other Member countries, and to liberalize fully their expenditure on services. Further, in so far as they are able to make long-term loans to other members they will, in so doing, be assisting in assuring the proper functioning of the system.

89. The Managing Board is very conscious that the Union in its present form is not perfect. It is necessary, of course, to distinguish between the defects inherent in the Union's arrangements on the one hand, and on the other hand those features of its working which reflect the difficulties created by present world conditions, or which can only be remedied if the member countries make the necessary effort. In the main it may fairly be said that the Union's arrangements not only give an incentive to both creditor and debtor countries to seek a fundamental equilibrium, but also provide them with assistance in their task. Nevertheless, the provision of mutual convertibility of the currencies of all members within a relatively liberal set of trade and payments regulations is not pure gain; it means that the system contains certain inherent contradictions which may - and indeed have - become important.

90. The Union functions as though the currencies of all members can be treated as equally valuable; indeed a payments system based on such an assumption is essential for any multilateral trade system. In fact, however, this operating assumption disguises the realities. The currencies of Europe were not equally strong when the Union was founded, and have not become so. No doubt the greater freedom from exchange restrictions and consequent increase in trade, which E.P.U. has helped to promote, tend to strengthen the weaker currencies. But meantime inequalities continue, not created by E.P.U.; and with the increased freedom of movement introduced by E.P.U. these inequalities tend to produce new problems.

91. As an example of these problems, it has become evident to the Board, in increasing degree throughout the year, that capital movements are taking place towards the stronger currencies, with a tendency to increase the creditor position of such countries. This poses a serious problem. A creditor country with a strong currency may, in its own interests and in conformity with its international obligations, have moved towards convertibility into dollars. This action may have taken place in the strict monetary sense of the word, or it may take the form of a more liberal import policy from the dollar area than other members are able to support. One member, Switzerland, whose currency is convertible into dollars has found it necessary, in order to reduce the strain on its quota, to control very carefully capital movements to and from other Member countries. Other countries, Portugal and Belgium, which have not imposed such restrictions in their relations with other members, have seen their quota more rapidly used than was desirable either in their own interests or in those of the Union.

92. Fundamentally, this problem arises because, though all members of E.P.U. are working towards the same end, some of them are much nearer to convertibility than others and are able to be more liberal in their commercial relations with the outside world. It had been hoped that the resources of the Union would provide sufficient time for the members with weaker currencies to take the necessary action to attain the position reached by the stronger ones before this problem created any serious difficulties. In this action they could expect to receive valuable assistance from other members, since, as stated above, the introduction of E.P.U. provided considerable incentives to creditors and debtors alike to secure equilibrium at a high level of trade. Moreover, E.P.U. also produced a mental attitude favourable to multilateral convertibility and an attack on black markets and the conditions which produce them; the complementary action by the Organization to liberalize trade and invisible transactions made a further contribution. The task has, however, been made much more difficult by the development of the world economic and political situation during the last year. The general advance towards convertibility has not been achieved, and a number of countries have serious deficits in their balance of payments, both overall and within E.P.U.

93. The problem resulting from this situation will necessarily appear in its most acute form when a creditor has accumulated surpluses with E.P.U. greater than its quota. The Agreement made no provision in advance for the settlement of any subsequent surpluses, so that in the absence of a further agreement the member has no effective course open other than to withdraw from the Union. No doubt the matter was left on this basis partly because the action to be considered appropriate would depend so largely on the surrounding circumstances. If all had gone well and members generally had attained a satisfactory over-all balance of payments there would be no difficulty for the Union in paying further surpluses fully in gold: this would be the logical result for a country which was in surplus within E.P.U. but in deficit outside, just as it would be appropriate for countries in the opposite position to be steadily paying in third currencies in the way discussed above (paragraph 85). The regional payments scheme would, in effect, open out to cover world-wide payments.

94. If, however, a creditor reaches the limit of his quota before this wider equilibrium has been attained, there is a very real difficulty in reconciling the natural desire of the creditor to receive full settlement as soon as possible, with the actual position of the weak members and of the Union itself. It is clearly in the interests of the Union as a whole that an agreed solution should be found, so as to avoid the automatic suspension of extreme creditors, and it seems desirable to set out some of the basic points on both sides which have to be reconciled as far as possible. A fully satisfactory solution is, of course, impossible so long as the basic facts represent a condition of disequilibrium in the payments of certain countries, or an equilibrium can only be found with a very low level of activity and trade. Any interim arrangement must not only be a reasonable compromise between different interests, it must also give full incentive to all parties to work towards a more fundamental solution.

95. One of the basic difficulties about immediately introducing 100 % settlement in gold for creditors who have exceeded their quota is that it would imply that other members, taken as a group, were paying gold for imports from the creditor which they had to admit without restriction, even though many of them were severely limiting or even prohibiting such imports from the dollar area. Moreover, the incentive to the creditor to assist the weaker members of the Union by a liberal import policy and a moderate export policy for non-liberalized goods would have disappeared. In effect, the currencies of the other members would become fully convertible for that creditor, when they were not ready for it.

96. On the other side, a failure to pay 100 % in gold may raise very serious difficulties for the creditor. As regards its balance of payments, the failure to receive any immediate return for part of its European exports may force it to introduce very damaging restrictions on its imports from elsewhere, or else to lose gold. Internally, the need, to finance this export surplus to Europe may force it to postpone highly desirable investment projects, or risk the development of inflation. Moreover, although it may be prepared to assist the debtors by the measures discussed above, it may be very reluctant to go further and seek to limit its surplus in E.P.U. by introducing vexatious controls which will probably decrease the extent of its convertibility or its liberality towards the outside world. Above all, the creditor will wish to be reassured that any agreement to give further credits will not be self-perpetuating, by removing the pressure on debtors to work towards a balance as speedily as possible.

97. There is no reason whatever to suppose that a compromise arrangement cannot be found, as all parties have a considerable interest in avoiding a breakdown. Moreover, such an agreed arrangement is almost certain to be more satisfactory than the position which would have emerged in the absence of E.P.U. For it would be a great mistake to imagine that this whole problem has been created by the existence of E.P.U. and would have had no counterpart under a system of bilateral agreements. Under such a system a member without sufficient reserves to make continued gold payments would almost certainly take action if its financial relations with another member tended to involve it in considerable gold losses. Such action would tend to discriminate against the trade of its partner country, and the partner, rather than see its own trade suffer, would probably take the same or very similar measures as those which an extreme creditor in E.P.U. might adopt.

98. It is well known that a system of bilateral agreements produces grave distortions in the pattern of trade. It is perhaps as well to point out that although E.P.U. removed a large number of these, its operating assumption, that all currencies within the Union are equal, tends to produce distortions of a rather different kind. It ought to be desirable for an exporter to sell in a country where he can expect to mobilize his earnings. But, the countries with weaker currencies, being supported by external aid or having credit facilities available with the Union, may not limit sufficiently their imports or give sufficient stimulus to their exports, either by physical or financial measures, and the non-discrimination within E.P.U. makes administrative measures by exporting countries unnecessary or undesirable. Consequently, it is unquestionable that certain markets are more eagerly sought after by traders than they would be were it not for the existence of E.P.U. This is, of course, only a disadvantage if the weaker currencies prove in the end unable to re-establish their strength. Provided that, within a reasonably short space of time, those countries develop the capacity to pay either by exports or by other earnings for their current imports, the pattern which is now developing will be the reasonably accurate reflection of the trade pattern that is to come.

99. The Board has thought it right to discuss some of the difficulties which confront the Union and its Members. This emphasis on the difficulties and problems should not, however, be allowed to mask the great advantages which have already been secured, largely as a result of the Union's existence: liberalization of trade, liberalization of invisibles, elimination of many discriminatory practices, expansion of trade on a mutually advantageous basis. These advantages are well known and do not require lengthy description here, but they must not be forgotten.

100. Nevertheless, neither the Union nor any other instrument can be a panacea for all evils, nor can it remove the need for all members to take the actions necessary to put their affairs on a sound basis. The difficulties in the way of doing this have been increased during the year by world events, and notably by a serious deterioration in the terms of trade of most members. This may explain why the progress of many members towards convertibility has been disappointingly slow, but members cannot look to the Union to provide a magical protection against these misfortunes. A renewed effort is needed by one and all, and more especially by those which are furthest from equilibrium. Under the arrangements - some tacit, some explicit - which prevail between the members of the Union the effort will be a cooperative one, with both creditors and debtors playing their part, because it is in the interests of all that the currency of each one should attain the necessary strength; but inevitably the primary responsibility for the strength of the currency of each Member country rests with that country itself. Self discipline by all its members is a necessary condition for the maintenance of the sound state of the Union.

101. The Managing Board believes that the E.P.U. as it stands is as good an instrument as it is reasonably possible to find in present circumstances to assist members in the transition from the European Recovery Programme towards financial independence and convertibility. The Board has already advised the Council that it does not recommend any substantial change in the Agreement as it now stands. Only certain minor modifications, on which the Board has made separate recommendations, appear desirable at this time. That changes will be needed in a year's time is probably true. They are expected then and can properly be made then. For the moment, there are very great advantages for the European trading and financial community in maintaining an instrument, the workings of which are now understood and whose performance has not seriously belied the hopes of the members when they signed the Agreement.

The Managing Board takes this opportunity of expressing its appreciation of the work carried out by the Bank for International Settlements as Agent for the Organization.