Proposed Modification of Par Value of Dollar

Background Material

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Contents

II. The Smithsonian Agreement and Related Negotiations on Trade and Defense

The Smithsonian Agreement of the Group of Ten followed a period of international monetary adjustment, involving a generalized system of floating (but not freely floating) exchange rates, during 1971. The Agreement consisted of a series of interrelated measures designed to help resolve balance of payments problems, to restore more settled conditions to the exchange markets, and to provide a framework from which longer-term reform could evolve. It was also agreed that discussions should be promptly undertaken on measures for reform of the monetary system over the longer term, and several areas of reform to which attention should be directed were identified. 1/

The agreement on "near-term" issues comprised:
--a new pattern of basic exchange rate relationships among the countries concerned;
--provisional arrangements to permit up to 2-1/4 percent margins of exchange rate fluctuation above and below the new exchange rates;
--recognition that trade arrangements are a relevant factor in assuring lasting equilibrium in the international economy;
--agreement by the United States to propose to the Congress a suitable means for devaluing the dollar in terms of gold as soon as a related set of short-term trade expansion measures were available for Congressional scrutiny; and
--agreement by the United States to suppress immediately the 10 percent import surcharge and related provisions of the Job Development Credit.

A. Exchange Rate Realignment

During the week following the Agreement, the Group of Ten participants individually announced the exchange rates and exchange rate policies to which they had agreed. The Government of Canada announced that it would not immediately set a new fixed rate for the Canadian dollar, but instead would maintain temporarily a floating exchange rate and would permit fundamental market forces to establish the exchange rate without intervention except as required to maintain orderly conditions. Wider margins were adopted by the other foreign members of the group. The changes, and the new pattern of exchange rates for the U.S. dollar, are summarized in the table below. Annex 3 provides calculations of the average appreciation of certain foreign currencies vis a vis the dollar.

1/ The text of the Communique issued at the conclusion of the Smithsonian Agreement appears at Annex 2.

TABLE 1

Country	Type of Rate	Percent Change from IMF Parity of April 30, 1971 3/	Percent Apre- ciation Against U.S. Dollar 5,6/	Currency Units Per Dollar Old	New
Belgium	Central 1/	+2.76	+11.57	50BF	44.8BF
Canada	Float	*	*	*	*
France	Par	0.00	+ 8.57	5.55FF	5.12FF
Germany	Central	+4.61	+13.57	3.66DM	3.22DM
Italy	Central	-1.00	+ 7.48	625L	581.5L
Japan	Central	+7.66	+16.88	360¥	308¥
Netherlands	Central	+2.76	+11.57	3.62G	3.24G
Sweden	Central	-1.00	+ 7.49	5.17K	4.81K
Switzerland	Par 2/	+4.89	+13.88	4.37SF	3.84SF
United Kingdom	Par	0.00	+ 8.57	.42£	.38£
United States	Par	-7.89 4/	0.00	*	*

* Not applicable.

1/ "Central rates" have been established in some cases, in lieu of new par values, as the effective rates around which currency values will be maintained within certain margins pending formal par value changes.

2/ Switzerland is not a member of the IMF.

3/ Expressed as percent change in grams of gold per currency unit.

4/ If approved by the Congress.

5/ Expressed as percent change in U.S. cents per foreign currency unit.

6/ All changes are computed on the basis of par values of April 30, 1971.

The Group of Ten participants recognized that their agreement would trigger decisions on exchange rates by most other countries and indicated their view that it was particularly important that no country seek improper competitive advantage through its exchange rate policies. Changes in parities could be justified only on the basis of an objective appraisal which established a position of disequilibrium.

As of January 20, the International Monetary Fund had received indications from all but five of its members of their decisions on their exchange rate systems. 1/ All proposed exchange rate changes have been examined by the IMF in accordance with the principle outlined above and in accordance with the Fund's own Articles of Agreement, and the Fund has taken such formal action as was appropriate in each case to enable the rates concerned to be implemented.

B. Negotiations on Trade Expansion Measures

The Smithsonian Agreement noted that urgent negotiations were under way between the United States and the Commission of the European Communities, Japan and Canada "to resolve pending short-term issues at the earliest possible date" ... and "to establish an appropriate agenda for considering more basic issues in a framework of mutual cooperation in the course of 1972 and beyond." These negotiations addressed themselves both to a framework for negotiation of major trade issues, including issues which the United States considers of critical importance, and to a series of short-term questions.

One outcome of the negotiations was agreement between the United States and Japan to initiate and actively support in the GATT during 1973 (subject to such internal authorization as may be required) multilateral and comprehensive negotiations with a view to the exchange and greater liberalization of world trade. A similar agreement has been reached with the European Communities subject to approval by its Council.

1/ Exchange rate changes and the new dollar rate for each IMF member country are listed in Annex 4.

The talks also resulted in a series of practical steps to remove trade obstacles that have become an irritant in trade relations. These issues have by no means been fully resolved, but a beginning has been made. The Japanese Government has decided to undertake a series of trade liberalization steps of immediate value to the United States. Both countries have agreed to join in efforts during 1972 within GATT toward the removal of some trade barriers leading to comprehensive trade negotiations in 1973. An agreement in substance with the European Communities subject to approval by its Council covers similar issues.

In short, a broad understanding has been reached for future negotiations in a time frame that takes into account the fact that international trade is undergoing an adjustment process initiated by recent comprehensive and substantial currency realignments. In the case of Canada, the parallel short-term negotiations, dealing mainly with certain bilateral agreements and understandings that no longer fit the facts of our economic relationship, have not been brought to a successful conclusion.

The immediate reduction of some tariff and non-tariff barriers by our trading partners, apart from their immediate value, is evidence of their intent to minimize economic friction and expand trade in reciprocal negotiations. These unilateral steps do not completely fulfill U.S. desires, but together with the commitment to negotiate reductions in trade barriers over the longer term they do constitute recognition that improvements must be made in the trading system.

Short-Term Measures

The greatest progress toward liberalization in the immediate future with tangible benefits for the United States will be made by Japan. For several years there has been a large and growing deficit in our trade with Japan, partially aggravated by the maintenance of trade barriers initiated during an earlier relative weakness in the Japanese external position. While many important restrictions remain, the actions, supplementing the yen appreciation of 16.9 percent relative to the dollar, represent a useful contribution towards bringing the United States-Japan trade imbalance into reasonable adjustment. They are also a welcome sign that Japan wishes to participate more fully in international efforts to reduce barriers.

With respect to agricultural products, Japan will increase the quantity of imports permitted under quota of fresh oranges, orange and grapefruit juice, high quality beef; eliminate the duty on soybeans and tallow; and reduce the duties on turkey meat, soybean meal, vegetable oils and some 10 other products. A duty free tariff quota will be established for feeder cattle. The effective date for these changes will be April 1, 1972, the beginning of the Japanese fiscal year.

On industrial products, Japan will reduce tariffs on April 1, 1972, on automobiles, computers, computer peripheral equipment, machine tools, color film, X-ray film and some 30 other industrial products. Japan will also reduce the internal excise tax on large and medium sized automobiles. Effective February 1st, Japan removed import quota restrictions on light aircraft and light aircraft parts, computer peripheral equipment (not including memory or terminal devices), radar and radio navigational equipment for aircraft; light and heavy oil. A U.S. technical team will visit Japan this spring to discuss liberalization of restrictions on imports of computers and computer equipment In addition, Japan will grant more liberal treatment to the establishment in Japan by U.S. firms of wholly-owned subsidiaries for importation, wholesaling and servicing. Some actions are also being taken to reduce other Japanese non-tariff barriers.

The European Communities have also agreed in principle on some short-term measures that are pending approval of the Council of the European Communities.

The U.S. has agreed to participate in bilateral antidumping discussions with the Japanese at the technical level. The United States has agreed to consider proposing the elimination of the "Final List" (Section 402 (a) of the Tariff Act) method of customs valuation, contingent upon reciprocal actions by other countries. The United States may moderate its inspection measures of Japanese canned tuna as determined by the effectiveness of Japanese measures in meeting U.S. laws and regulations concerning decomposed canned tuna.

The U.S. has been concerned that certain trading arrangements with Canada no longer fairly reflect the economic circumstances surrounding economic relationships between our two countries. While it has not yet been possible to achieve appropriate balance in these arrangements, the United States will seek appropriate means of reducing imbalances in trade agreements with that country.

Conclusion

These negotiations have by no means settled the major issues outstanding in the field of international trade. Nevertheless, a beginning has been made. Certainly, there is greater recognition today of both the need for further progress and the dangers implicit in failure to achieve that progress. We look forward to major trading nations joining with us in seeking future steps to revitalize the world trading system.

C. Defense Financing Arrangements

The President's announcement of August 15, 1971, included the statement:

> "Now that other nations are economically strong, the time has come for them to bear their fair share of the burden of defending freedom around the world."

The implication was that the persistent U.S. payments problems were caused partly by the high level of U.S. defense expenditures abroad. If some of those defense burdens could be borne by other countries, the shift required in other U.S. accounts, including trade, would be smaller.

Some reduction of defense expenditures overseas could be expected as we withdrew from Vietnam. However, these savings could be dissipated by rising prices and the increased cost of foreign currencies. Important imbalances have remained within Europe. Thus we felt justified in proposing that Europe carry a larger share of the common defense burden, which would mean some increase in their defense responsibilities, greater contributions to the cost of maintaining U.S. forces in their areas, or a combination of both.

The U.S. wants to maintain fully the strength of the alliance. Unilateral reductions in U.S. forces might be followed by reductions in the forces of our allies rather than a compensating increase. Reductions should be the subject of negotiations with Warsaw Pact powers, not the result of unilateral action. The U.S. view was that forces of our European allies needed to be strengthened. Thus, a number of conflicting objectives had to be reconciled.

The result so far has been the signing of a new agreement for partially offsetting the cost of U.S. forces in Germany and announcement by our European allies that they intend to increase expenditures on their own defense forces by more than $1 billion in 1972. These agreements are steps toward maintaining the strength of our common defense with a smaller proportionate burden on the United States. However, the increased expenditure by our European allies on their own defense forces, except as it may involve procurement from the U.S., will not directly reduce our payments deficit. Nor will the share of European gross national products spent on defense be larger than in previous years.

Consequently, this area will need further examination and action in the year ahead. The alternative would be to achieve the adjustment needed in our international payments balance almost entirely in the trade sector of the balance of payments. Our trading partners may find preferable new arrangements enabling the U.S. to maintain its forces in Europe without imposing strain on the international payments balance, that is, with consequences for the payments balance no different from those of maintaining the same forces in the United States.