ECONOMIC AND SOCIAL COMMITTEE
OF THE EUROPEAN COMMUNITIES

MONETARY DISORDER

OPINION

Brussels 1978

The European Communities' Economic and Social Committee, chaired by Mr Basil de FERRANTI, approved this opinion at its 160th Plenary Session, which was held on 20 and 21 June 1978.

The preliminary work was done by the Section for Economic and Financial Questions and the Rapporteur was Mr Yvan CHARPENTIE.

ECONOMIC AND SOCIAL COMMITTEE
OF THE EUROPEAN COMMUNITIES

O P I N I O N

MONETARY DISORDER

Brussels, June 1978

This publication is also available in Danish, Dutch, French, German and Italian.

A bibliographical slip can be found at the end of this volume.

TABLE OF CONTENTS

Pages

Pages

Pages

B. OPINION OF THE COMMITTEE ON THE COMMUNITY APPROACH TO THE PRESENT INTERNATIONAL MONETARY DISORDER

*

* *

A. REPORT OF MR CHARPENTIE

Introduction

The international monetary situation became even more unstable towards the end of 1977 and in the early part of 1978. Exchange rates fluctuated widely and the US dollar went into a rapid slide. Were this state of affairs to continue it could, in the longer term, have an adverse effect on the economic situation and on employment in the Community.

It could also spark off new increases in oil prices.

Monetary instability is harmful to good international relations, undermines efforts being made in Europe and elsewhere to conquer the problems of inflation and unemployment, and encourages protectionist tendencies which are already affecting world trade and are threatening to spread to intra-Community relations.

Confronted with this situation, the Economic and Social Committee decided to consider the issue on its own initiative and to attempt to define the conditions for a "Community Approach to the Present International Monetary Disorder".

Such is the aim of the present Report and Opinion, which look into existing ways and means of tackling the problems at both international and Community level.

The Economic and Social Committee does not set out to propose technical or political solutions. Experts and political leaders have already been studying and discussing these for several years now. Its aim is a more modest one : to suggest certain lines of approach and determine the conditions for a return to normality. The Committee is well aware, however, that the ultimate aim must be to eliminate international monetary disorder and intolerable balance-of-payments disequilibria, and that to this end it is necessary above all to seek a better balance between growth and stability at world level.

1. SURVEY OF THE MAIN MONETARY EVENTS SINCE BRETTON WOODS AND ANALYSIS OF THE PRESENT SITUATION

a) Survey of the main monetary events since Bretton Woods

Before passing judgement on the current international monetary disorder it would be useful to briefly recall the major milestones of recent monetary history and describe as simply as possible the complex problem of world currency relationships and the rules governing these relationships in 1978.

General observations on the international monetary system

The right to print money is a regalian right, i.e. a right connected with the exercise of sovereignty. This explains why the privilege of being able to create money has gradually become a State monopoly, even if the State itself puts the actual job in the hands of a bank of issue constituted under private bar.

There are no problems of principle regarding a currency circulating within the territory under the jurisdiction of the issuing State, since the public authorities of that State can always decree a compulsory rate for the currency issued there.

But it is quite a different matter when it comes to a State wanting to get its currency accepted by economic operators who do not come under its authority, for example when it wants to pay for imports in its own national currency.

Hence all the difficulties and complexity of international currency relationships.

A currency will in point of fact only be accepted if people have confidence in it and in the issuing authority. In other words it must have credit worthiness.

For centuries and indeed until quite recently (15 August 1971 to be exact) it was believed that this could be achieved by using as national or international currency precious metals (gold and silver) with an intrinsic value or currencies that were convertible into gold (gold standard or gold exchange standard).

The obvious strength of such a system was that all par value or exchange rate problems could be solved, since the gold standard was immutable - at least in theory. The only snag was that gold production and stocks lagged way behind the needs of national economies and the expanding volume of world trade. To get round this difficulty a whole host of systems were conjured up, all of which led to the creation of "monetary symbols" on the part of issuing authorities, whilst the fiction of a tie with gold was preserved. In fact, what was really happening was that pyramids were being built upside down and they were tottering precariously on their apexes.

<u>Bretton Woods</u>

Although the war had brought about a wholesale redistribution of bullion reserves between countries, Bretton Woods was in no way an exception to the rule described above but merely reaffirmed the pivotal role of gold in the international monetary system, since IMF members had to declare the par values of their currencies in terms of gold or the dollar (35 dollars equalled one ounce of fine gold) and were required to buy or sell their own currency as appropriate in order to ensure that the market rate kept within a margin of 1% on either side of the declared par value.

Par values could be adjusted only with the prior approval of the IMF and only if there was a "fundamental disequilibrium", a notion that was never precisely defined. The two basic aims of the Bretton Woods Agreement were to :

- fix exchange rates between the currencies of IMF members numbering 44 in 1946 and 127 today) since these exchange rates were expressed in terms of gold;

- institute a system for settling payments, as well as a system for extending credit to deficit countries, through the use of drawing rights based on quotas equivalent to members' subscriptions in gold or in their own currency.

Finally, Article 8 of the Articles of Agreement of the IMF made it compulsory for each member, after the transitional period, to remove all exchange controls in respect of current transactions and to guarantee, vis-à-vis other countries, the convertibility of its own currency for the settlement of such transactions.

Implementation of the Bretton Woods Agreement

The proposed objectives were only partially attained and the disequilibria set in motion by the Agreement finally brought about the downfall of the system.

The goal of fixed exchange rates was not fully attained due to failure to apply the relevant measures rigorously. Some countries never declared par values, others declared several par values (multiple exchange rates) and yet others floated their currencies without incurring any sanctions.

Most devaluations were decided on without the agreement of, or even prior consultation with, the IMF, so that during the thirty years the Agreement was in operation there were considerable exchange rate adjustments between currencies, even though these adjustments had the advantage over floating of being officially registered in devaluations or revaluations in terms of the key currency, the dollar.

One thing in the IMF's favour that must be recognized, however, is that the Fund has made it much easier for central banks to settle payments with one another, and this in turn has furthered the development of world trade. The IMF has achieved this by regularly increasing drawing rights and expanding credit facilities through :

- the introduction in 1952 of the gold tranche (for which the agreement of the IMF is automatic) and stand-by credit (where authoritization is given for a specific period of time and the credit can be used any time during that period);

- the introduction in 1953 of compensatory finance facilities, particularly for the benefit of developing countries to compensate for fluctuations in their export earnings;

- the introduction in 1968 of Special Drawing Rights in addition to the ordinary drawing rights based on quotas and subscriptions to the Fund.

The IMF has frequently come to the aid of countries threatened by serious balance-of-payments disequilibria.

Finally, the Bretton Woods system can also take credit for the fact that a good many countries have got rid of exchange control and made their currencies convertible once more.

It is fair to say then that, if the Bretton Woods Agreement had been applied more rigorously, it might have lasted and even survived the crisis resulting from the four-fold increase in oil prices. Unfortunately, however, it carried within itself the seeds of disequilibria and tensions.

The dollar crisis and the end of the Bretton Woods System

Though officially pegged to gold, the par values of national currencies were also pegged to the dollar. In fact the Bretton Woods Agreement explicitly provided for this by putting the dollar-gold link on an official footing, even though there was no question of currencies being tied officially to the dollar. This thinking was understandable at a time when the United States held the bulk of the world's gold reserves and it was inconceivable that the dollar could be devalued in terms of gold.

In these circumstances, central banks and economic operators preferred to hold dollars or dollar claims (Eurodollars) which, whilst providing the same security as gold, were superior in that they brought in interest: "the dollar is gold that earns interest", as the saying went.

The United States thus found it hard to resist the temptation to export substantial amounts of capital to industrialized countries and this led to a disequilibrium in its balance of payments.

So, whilst the United States accumulated long-term claims against foreign countries, the latter accumulated current claims against the United States; these claims increasingly outbalanced American gold stocks.

In the early 1960s, this situation brought on a first loss of confidence in the dollar and measures were taken to control gold speculation.

The proper remedy would have been to bring the United States' balance of payments permanently into equilibrium. Unfortunately, however, the appearance of inflationary tendencies in the United States, a trade deficit at the end of the 1960s, and the need to finance the Vietnam war and foreign aid all conspired to steadily worsen the US payments deficit.

To protect its currency and honour its commitments, the United States was forced to dip into its gold reserves. In fact, its stock of gold fell to the equivalent of about 10,000 million dollars in the spring of 1971, when there was a new burst of speculation in gold, the German mark, other European currencies and the yen, whilst gold rose to 45 dollars an ounce on the free market.

On 15 August 1971, the President of the United States suspended convertibility of the dollar into gold and into other foreign currencies. This effectively marked the end of the Bretton Woods system.

The Smithsonian Agreement

The Smithsonian Agreement concluded by the Group of Ten in December 1971 was designed to put an end to the world monetary chaos that had existed since the decision of 15 August 1971.

Under the Smithsonian Agreement :

- a new set of par values in relation to the dollar were fixed for the main currencies;

- the dollar was devalued by 8% in terms of gold (from 35 dollars per ounce to 38 dollars per ounce); this was the first devaluation of the dollar since 1934 and the third since 1792;

- the bands within which exchange rate fluctuations were allowed were widened from 1% to 2.25% either side of parity.

Although the United States maintained non-convertibility of the dollar into gold - which made the parity of 38 dollars to the ounce wholly academic - the dollar nevertheless retained its dominant position, since it was in terms of that currency that the exchange rates of other currencies continued to be expressed.

Under the Smithsonian Agreement then, the United States was released from all obligations and constraints (i.e. convertibility of the dollar into gold), though at the same time it retained all the privileges reserved for the dollar. It should be recognized, however, that such privileges were, to a large extent, a reflection of the confidence which central banks and economic operators continued - perhaps faute de mieux - to place in the American currency.

From the Smithsonian Agreement to the Jamaica Agreement

The Smithsonian Agreement in fact solved nothing and the world entered a period of monetary anarchy that was by no means a short-lived phenomenon.

The United States' payments deficit continued to grow : liquid funds expanded dangerously and the dollar steadily depreciated, whilst harder currencies (particularly the German mark) rose in value on a large scale (50% increase in terms of the dollar and 20% increase in terms of all the other main currencies between 1970 and 1975). Speculation against the dollar returned with renewed vigour and at the beginning of 1972 one ounce of fine gold was worth 50 dollars.

Faced with this increasingly anarchistic situation, individual countries as well as international institutions began to look for solutions - or at the very least palliative measures.

In April 1972, the Member States of the EEC conceived the idea of the European "snake" and undertook to ensure that the exchange rates of their currencies did not fluctuate by more than 2.25% (giving a maximum divergence of 4.5% between any two EEC currencies), while remaining within a broader band in relation to the dollar (the tunnel).

The IMF decided to set up the Committee of Twenty to prepare a reform of the international monetary system. Several developing countries were members of this Committee.

In June 1972, however, the United Kingdom decided to float the pound and her example was soon followed by Italy (January 1973).

Early in 1973 there was a new upsurge in world speculation against the dollar, which was devalued from 38 to 42.22 dollars per ounce of gold.

Japan and Switzerland decided to float their currencies and in March 1973 the countries of the "snake" agreed to do likewise in relation to the dollar. The "snake" left the tunnel. The tunnel in fact no longer existed.

In spite of everything, the EEC tried during this period to make further progress towards economic and monetary union, and in April 1973 set up the European Monetary Cooperation Fund (EMCF), to be administered by the Bank for International Settlements (1).

---

(1) See infra.

Finally, at a meeting held in Nairobi in September 1973, the Committee of Twenty laid the foundations for new monetary rules.

The main elements of the new system included :

- stable but adjustable par values (i.e. something midway between fixed parities and floating exchange rates);

- the protection of exchange rates between any given pair of currencies, as in the European "snake" and no longer between an individual currency on the one hand and the dollar on the other; the dollar thus lost its previously privileged position;

- arrangements whereby the responsibility for restoring balance would no longer lie solely with debtor countries but would also be shouldered, where appropriate, by creditor countries.

A few weeks after the Nairobi Conference came the oil crisis and, concurrently, a general rise in raw material and foodstuff prices. This threw the whole question open again, affected the balance of power and resulted in a geographical redistribution of foreign exchange reserves.

To help oil and raw material importing countries, the EEC (at Zeist in April 1974) and the IMF (in June) decided to mobilize gold assets at the free market rate. Some countries in fact revalorized their gold reserves.

These measures, however, were but palliatives and in 1974 the IMF took two decisions one after the other, in order to continue, despite everything along the chosen path and attend to the most urgent needs :

- the value of the SDR would be fixed in relation to a "basket" of currencies instead of gold or the dollar;

- there would be a general increase in quotas.

Links with the gold standard and the dollar were thus abandoned and replaced by a unit of account as the pivot of the monetary system.

The SDR was related to a basket of 16 currencies which included :

- 0.40 US dollar
- 0.38 German mark
- 0.045 pound sterling
- 0.14 French franc.

The composition of the basket was calculated in such a way that on the first day of operations, i.e. 28 June 1974, each of the 16 currencies was weighted more or less in line with its share in world trade. The dollar no longer enjoyed absolute pre-eminence, since the currencies of the EEC countries taken together in the basket carried more weight than the US dollar.

The SDR is not a genuine standard, since in reality it is but a convenient way of evaluating a currency in relation to all the other currencies in the basket. In the present monetary system a standard no longer exists.

The value of a currency can be recorded; it cannot be determined.

The SDR nevertheless has the immense advantage of enjoying a certain stability, since it represents the weighted average of the values of the currencies, some of which appreciate when others depreciate.

To meet the ever-growing payments needs of different countries, paricularly the developing countries and the oil-importing countries, the IMF has regularly reviewed quotas and hence drawing rights in the years following the decision of June 1974. For all that, the monetary system has become more and more unstable and is characterized by the widespread, unmanaged floating of currencies (except for the small nucleus of countries still left in the European "snake" following the withdrawal of France in July 1975).

Experts have not lost hope, however, of reintroducing working rules acceptable to the majority of countries. A step in this direction was the Jamaica Agreement adopted by the Committee of Twenty on 7 and 8 January 1976 on the basis of studies carried out by the Interim Committee. A number of observers even saw another Bretton Woods in the overall agreement worked out in Jamaica.

Under this agreement, an attempt was made to base the international monetary system on a reserve asset that is not the currency of any given IMF member. This principal reserve asset is the SDR. At the same time gold lost its privileged position and its role as a standard.

The Jamaica Agreement provides for :

- abolition of the official price of gold and authorization for central banks to carry out transactions in gold at prices based on market rates;

- removal of the reference to gold from the Articles of Agreement of the IMF. Par values may no longer be expressed in terms of gold but must be expressed in SDRs or any other denominator decided on by the Fund;

- the gold held by the IMF (154 million ounces in all) to be either returned to members or to be sold for the benefit of the developing countries, over a period of four years.

To encourage the return to a system of stable but adjustable parities, the Jamaica Agreement stipulates, by means of an amendment to Article IV of the IMF Articles of Agreement, that every member must initially notify the IMF of the exchange measures it intends to take.

These measures may comprise :

- either maintaining the value of a currency in terms of the SDR or in terms of another denominator other than gold;

- or maintaining the value of a currency in relation to another member currency or currencies, in order to form joint float areas (along the lines of the European "snake");

- or taking any other step decided on by the member in question.

At a later date - and depending on international economic conditions - the IMF may decide by a majority of 85% (which implies US agreement) to institute a system of stable but adjustable parities.

These parities will be fixed in terms of the SDR or any other common denominator chosen by the Fund (though it will be neither gold nor any individual currency) and the maximum fluctuation permitted will be 4.5%.

The IMF would have the task of supervizing this arrangement and would be able to veto any parity adjustment that did not appear to be justified.

The Jamaican Agreement, which officially came into force on 1 April 1978, thus initiates a cooperation strategy that involves flexibility at the present time and firmer discipline in the future. All this will only be successful, however, if the IMF is able to effectively exercise the powers vested in it and if the members are ready and willing to accept the IMF's directives.

Moves to organize a Community monetary system (1)

The provisions of the Treaty

The Treaty of Rome lays down the following two general principles in Article 3 :

- the abolition, as between Member States, of obstacles to freedom of movement for persons, services and capital;

- the application of procedures by which the economic policies of Member States can be coordinated and disequilibria in their balances of payments remedied.

---

(1) As regards the period before 1973, reference can be made to the ESC Report and Opinion of 11 December 1973 on the Communication from the Commission to the Council on the progress achieved in the first stage of economic and monetary union, on the allocation of powers and responsibilities among the Community institutions and the Member States essential to proper functioning of economic and monetary union and on the measures to be taken in the second stage of economic and monetary union (Rapporteur : Mr MAMERT).

On the latter point, the Treaty provides for :

- coordination of the economic policies of the Member States through cooperation between their appropriate administrative departments and between their central banks (Article 105);

- liberalization of payments connected with the movement of goods, services or capital, as well as transfers of capital and earnings (Article 106);

- policy with regard to rates of exchange to be treated by each Member State as a matter of common concern (Article 107);

- authorization for the Member States to take, for a strictly limited period, the necessary measures to counter the consequences of exchange rate alterations which seriously distort conditions of competition (Article 107);

- mutual assistance (which may take the form of limited credits) decided by the Council by a qualified majority, where a Member State is in difficulties or is seriously threatened with difficulties as regards its balance of payments (Article 108);

- the possibility for a Member State to take, as a precaution, the necessary protective measures in the event of a sudden crisis in its balance of payments (Article 109).

As regards the free movement of capital, the Treaty provides for :

- liberalization of movements of capital connected with current payments between Member States (Articles 67 and 68);

- progressive coordination of the exchange policies of Member States in respect of the movement of capital between those States and third countries (Article 70);

- the Commission to be kept informed by the Member States of any movements of capital to and from third countries which come to their knowledge (Article 72);

- authorization by the Commission for a Member State to take protective measures should movements of capital lead to disturbances in the functioning of its capital market (Article 73).

The institutions

As far as monetary institutions are concerned, the Treaty provides only for the setting-up of a Monetary Committee (composed of experts) with advisory status. It has the following tasks :

- to keep under review the monetary and financial situation of the Member States and of the Community and the general payments system of the Member States and to report regularly thereon to the Council and to the Commission;

- to deliver opinions at the request of the Council or of the Commission or on its own initiative, for submission to these institutions.

Two other institutions were subsequently found to be necessary :

- the Committee of Governors of Central Bank, which was set up in 1964 and whose functions were re-defined and expanded by the Council Decision of 22 March 1971;

- the European Monetary Cooperation Fund (EMCF), which was decided on at the Paris Summit Meeting in October 1972 and came into operation on 1 June 1973.

The EMCF's board is composed of the governors of the EEC central banks, a representative of Luxembourg and a representative of the Commission. The Bank for International Settlements in Basle acts as the EMCF's agent for the multilateralization of claims and debts and intra-Community settlements, which the EMCF has the task of promoting.

The machinery

As the weaknesses of the international monetary system became apparent, so the idea of a genuine economic and monetary union supplementing and reinforcing customs union grew.

As early as 1962, the Common Agricultural Policy had led to the introduction of an agricultural unit of account for intra-Community transactions concerning farm produce.

In 1968 Mr BARRE, acting on behalf of the Commission, submitted (without success) a plan providing for :

- a commitment on the part of the Member States not to change their parities without mutual agreement;

- elimination of the margins of fluctuation of exchange rates between EEC currencies;

- organization of mutual financial assistance between EEC countries (it had been practically impossible to apply Article 108 of the Treaty, since the provisions were not sufficiently precise).

The following year the Commission issued a memorandum on the coordination of economic policies and monetary cooperation within the Community (BARRE Memorandum), calling for :

- greater alignment of medium-term economic policies through better synchronization of national programmes;

- closer coordination of short-term policies through more intensive inter-governmental consultations, comparison of budgets, improvement of statistics and application of a warning indicator system;

- the introduction of Community monetary cooperation machinery providing short and medium-term support.

The broad lines of this plan were approved by the Council in January 1969 and the various elements were implemented in 1970 and 1971.

In the monetary sphere, the short-term monetary support system created on 9 February 1970 involved the setting-up of a 1,000 million dollar support fund for the granting of financial assistance for a period of three months, renewable at the market rate. But, use of this fund was subject to such conditions - particularly as regards interest rates - that it offered hardly any advantage over the swap network set up on the initiative of the United States (in which the Federal Reserve Bank formed the pivot).

In order to move ahead with economic and monetary union, the Heads of State, meeting at The Hague on 1 and 2 December 1969, decided to work out a plan (the WERNER Plan) for achieving by 1980 a genuine Community monetary system based on :

- total and irreversible mutual convertibility free from fluctuations in rates and with immutable parities or preferably their replacement by a single Community currency;

- the creation of liquidity throughout the area and the centralization of monetary and credit policy;

- transfer to the Community authorities of competence for monetary policy towards the outside world;

- unification of Member State capital market policies.

The disorder in the international monetary system, however, forced the Commission and the Council to take more urgent steps, and the Council decided on the following on 22 March 1971 :

- the introduction of medium-term monetary assistance machinery in accordance with the BARRE Memorandum;

- intensification of the coordination of Member States' short-term economic policies;

- intensification of the cooperation between Member State central banks, particularly in the Committee of Central Bank Governors;

- the introduction as from 1 June 1971 of machinery for narrowing the margins of fluctuation between the various Community currencies.

The narrowing of exchange-rate fluctuation margins or the "snake"

Under the European Monetary Agreement of 1955 between the European CEEC member countries (which came into operation in 1958 and is now defunct), the margin of fluctuation between a European currency and the dollar had been fixed at 1.5% (giving a maximum divergence of 3% between two European currencies).

Under the decision of 22 March 1971 the maximum divergence between EEC currencies was to be reduced initially to 1.2%, with further reductions to follow. Intervention was to be exclusively in dollars, and so the aim of reaching agreement on intervention in Community currencies was deferred to a later stage.

The decision of 22 March 1971 had not yet come into force, however, when a wave of speculation in European currencies led in May to complete disruption of the foreign exchange markets. The crisis ruined the plan for European monetary alignment, and on 15 June 1971 the margin of fluctuation between the German mark and the French franc, instead of being reduced to 1.2%, increased to 6 - 7%.

The Smithsonian Agreement of December 1971 introduced new parities and widened the fluctuation margins : the divergence between two European currencies could now reach 4.5% (or 9% over a period).

On 21 March 1972 there was a new Community decision, which found expression in the agreement of 24 April 1972, under which :

- the United Kingdom and Denmark (which were to accede to the EEC on 1 January 1973) and Norway joined the six Community States in adhering to the agreement on the narrowing of fluctuation margins;

- the intra-Community fluctuation margin was reduced to 2.25% (or 4.5% over a period);

- intervention to keep the "snake" in the "tunnel" was to be in dollars, but any intervention to keep each of the European currencies in the "snake" was to be in Community currencies, which meant the setting-up of an intra-European settlement system.

Management of the Community foreign exchange system

The European summit meeting in October 1972 confirmed these decisions and redefined the functions of the European Monetary Cooperation Fund, which were initially to be as follows :

- concerted action among the central banks for the purpose of narrowing currency fluctuation margins;

- the multilateralization of positions resulting from interventions in Community currencies and the multilateralization of intra-Community settlements;

- the use for this purpose of a European monetary unit of account;

- the administration of short-term monetary support among the central banks (introduced in February 1970).

The EMCF's machinery is as follows :

- An accounting system for claims and liabilities resulting from interventions by central banks in Community currencies for the purpose of ensuring observance of the limits of fluctuation indicated above.

- A system for offsetting claims and liabilities resulting from one and the same accounting period and which, for this purpose, are expressed in a common denominator (the European monetary unit of account). This EMUA is still defined in terms of gold, which is inevitably a theoretical definition since gold has lost its former functions as an international means of payment, etc. However, the anachronism of the gold-based definition does not cause any difficulty and the necessary transactions are conducted by using EMUA-national currency conversion rates.

- A system of very short-term credit of unlimited scope for an "end of month - 30 days" period (corresponding on average to a 45-day period) automatically renewable for three months within a limit equal to the debit share of the central bank concerned in the short-term monetary support. This renewal facility can be used only to the extent that it does not lead to continuous indebtedness for more than six consecutive months.

- A system for settlements, operating according to the composition of the reserves (dollars, SDRs, reserve positions in the IMF) held by the debtors.

Operation

The main ideas behind the creation of the EMCF stem directly from the traditional practices of the central banks, which, of course, had left a very clear mark on the agreement of 10 April 1972. They are evident in particular in :

a) The institutional features and the practical operation of the EMCF, the central banks tending to avoid as much as possible the Board's supervision, which some central banks (in particular the Bundesbank) consider to constitute an encroachment on their legal prerogatives as bodies which enjoy relative autonomy vis-à-vis governments.

b) The lack of automatic offsetting over time in relations between banks of issue; thus, although operations conducted within one accounting period (one month) are multilateralized with a view to being offset, there is no automatic offsetting between positions taken from two different accounting periods. One and the same central bank may, in principle, be a creditor and a debtor simultaneously in the EMCF's books. However, offsetting "by arrangement" does take place in practice.

c) Bilateralism still occurs :

in the case of renewal by mutual agreement; this is possible

. where a debt has already been renewed automatically for three months; and

. where a debt exceeds the debit share of the central bank concerned in the short-term monetary support.

- in connection with credit extended as short-term monetary support : in this way each central bank can, for example, stipulate the currency in which it extends a given credit; in the case of the credit granted to Italy, all the central banks chose the US dollar at an exchange rate frozen at the level prevailing at the time the credit was made available; in view of the slenderness of the resources available under this credit system and the risks which any bank using it would run, the banks of the countries in the "snake" have never used it; in most cases they have even made only limited use of the system of very short-term credit preferring to re-establish their position by re-purchasing their currencies on the market.

d) The changes which have come about in the application of the initial rules concerning interventions; these seem to be very much influenced by the desire to have an automatic mechanism. This aim has not been fully achieved owing to the complex situations which occur. In practice, consultation procedures have been introduced. In theory the consultation takes place in advance, but frequently it is on an *a posteriori* basis, that is to say, action is announced which has already been taken or which is being prepared. In the latter case, the action is postponed should the relevant central banks have objections.

e) Lastly, the tendency to limit the powers of the EMCF for the reasons given in (a) and (c) above has been accentuated by the fact that the central banks make only limited and occasional use of Community currencies in their interventions. The dollar is most frequently used, but in this case the interventions are not registered in the books of the EMCF and therefore do not give rise to offsetting. This trend can be put down to several factors, including the following :

. From a purely technical point of view, the fact that positions are settled in the EMCF mostly in dollars (now that gold is no longer used) and the fact that the limited size and duration of the very short-term credits do not encourage countries in the "snake" to take advantage of EMCF machinery.

. From a wider point of view, the fact that the dollar continues to a great extent to hold the key position in international currency relationships and that the monetary authorities consistently baulk at remedying this situation for fear that reform, within a European framework, will lead to changes looked on as curtailing national monetary sovereignty.

Balance sheet of the moves to organize a Community monetary system

After the conclusion of the agreement of 24 April 1972, the international monetary system experienced many upheavals which shook the foundations laid at Washington in 1971. It was the Jamaica Agreement (which has just come into force) that enabled new rules to be drawn up.

The oil crisis, inflation, and the resulting balance-of-payments disequilibrium in many countries further aggravated the currency situation throughout the world.

In the Community, only five of the nine countries participate in the "snake". The United Kingdom, Italy and France have left in succession, while Ireland was unable to join. The exchange rate fluctuations between the "snake" currencies and the currencies that are no longer in the "snake" have been considerable (over 8 years, from September 1969 to October 1977, the German mark has appreciated by 60.4% in relation to the French franc and by 139.3% in relation to the pound sterling.

While the Community's aggregate balance of payments on current account is now in surplus, there are still disequilibria in a number of Member States.

Despite the introduction of monetary compensatory amounts in 1969, exchange-rate fluctuations are complicating the operation of the Common Agricultural Policy.

While the mutual assistance provided for in the Treaty of Rome has helped certain Member States, it has not led to genuine solidarity owing to the lack of an effective mechanism for intervening on the exchange markets.

The economic and monetary union project has been stagnating. As the Commission noted in its Communication of 17 November 1977 :

> "the intermediate objectives originally set have not been achieved and the transition to a second stage on the way to economic and monetary union has not taken place. The system introduced in the monetary field now covers only a few of the Member States".

The Commission also makes the following observation :

> "The division of the Community into ill-coordinated monetary zones has been perpetuated; divergences in the value of currencies have jeopardized the unity of agricultural prices and freedom of movement for agricultural products. The customs union itself, though preserved intact in its essentials, continues to be threatened by the temptation of a return towards national markets".

2. The present monetary situation

The main monetary events since the Bretton Woods Agreement having been outlined, it is possible to define the basic features of present currency relationships in the world as a whole and within the EEC in particular.

Main features of world currency relationships

The situation in which the Jamaica Agreement is being applied is very different from that at the end of the Second World War in which the Bretton Woods Agreement came about.

The United States no longer officially holds the pre-eminent position it had immediately after the War :

- the USA then held 80% of world gold stocks, whereas it now has only about 25%;

- the dollar is no longer convertible into gold at a fixed rate and can no longer play the role of a monetary standard;

- the United States' permanent deficit on its balance of payments gives grounds for a growing lack of confidence in the dollar. Since 1971, the dollar has considerably depreciated in relation to the German mark, the yen and the Swiss franc, which are considered to be strong currencies.

On the other hand, the dollar is still widely used as a reserve currency by the central banks and as a money of account or settlement for the bulk of international commercial transactions. International claims are frequently denominated in dollars. For the United States this has the great advantage of enabling it to pay for its imports - and, in particular, its oil imports - in its own currency without having to worry about keeping its balance of payments in equilibrium.

There are many countries whose currencies are still tied de facto or de jure to the dollar (Canada, Japan, certain countries in the Far East and Latin America, South Africa, Israel, etc.), forming what can be regarded as a real dollar area. The extent and cohesion of this area are at present seriously jeopardized by the instability of the dollar rate of exchange owing to structural factors. This instability is liable to increase rather than diminish in the coming years (considerable and growing deficit on the US balance of payments, difficulties hampering intervention by the US monetary authorities to support the dollar, due in the main to the fact that the bulk of US reserves are in gold - 12,000 million dollars out of 19,000 million dollars at the official rate of 43 dollars per ounce of gold, or 40,000 million dollars out of 47,000 million dollars at the market rate of 180 dollars per ounce of gold).

The pattern of central bank holdings of foreign exchange reserves is now very different from that just after the Second World War and at the time of the dollar gap. These world reserves were estimated by the IMF to amount to 259,900 million SDRs (1 SDR = 1.28 dollars) as at the end of January 1978, and breakdown as follows :

- United States .... 36,720 million SDRs
- Federal Republic of Germany . 34,140 million SDRs
- Japan .... 20,050 million SDRs
- Switzerland .... 11,070 million SDRs
- OPEC countries .... 60,840 million SDRs
- Latin America (excluding Venezuela) .... 15,540 million SDRs
- Other industrialized countries .... 140,110 million SDRs

It can be seen that three countries are clearly in the lead - the United States, the Federal Republic of Germany and Japan (whose foreign exchange reserves rose by 25% in the first three months of 1978). This inevitably means that these countries carry special responsibilities in stabilizing the international monetary system.

It should be stressed that these exchange reserves include (besides gold and foreign currencies, in many cases the dollar) a new element - the SDR, whose stability in relation to certain currencies is a great advantage. The value of the SDR is not "quoted" but is based on the weighted exchange rates of a basket of currencies, some of which rise when others fall. Some countries are heavily in debt and their indebtedness is constantly increasing. This is particularly the case with the non-oil-producing developing countries, which have not derived any real benefit from the increase in the price of energy and industrial raw materials but rather have suffered from this increase. This Third World indebtedness towards the industrialized countries, which is at present estimated to amount to 250,000 million dollars, exceeds the debtor countries' ability to pay and calls for urgent, coordinated international solutions.

The volume of international liquidity has grown considerably in recent years, rising from 85,000 million dollars in 1970 to 300,000 million dollars in 1977. Euro-currencies (Euro-dollars and petro-dollars in particular) stemming in large measure from the ever-growing deficit on the US balance of payments and to a lesser degree from the deficits of other countries, from a mass of liquidity and short-term capital that poses a constant threat to currencies.

The Bretton Woods Agreement made possible the de facto elimination of exchange control and the introduction of extensive convertibility which has facilitated the development of international trade over the past decades.

But, gold and the dollar lost their status of monetary standard owing in particular to the laxity of the United States in the conduct of its economic and monetary policies and the rapid inflation which was a feature of many economies, particularly since the quadrupling of oil prices. The system of fixed exchange rates introduced at Bretton Woods gave way to general floating of currencies until the Jamaica Agreement, which provided for a return to stable but adjustable par values, inaugurated a new monetary system.

Of the arrangements introduced under the Bretton Woods Agreement, certain credit and settlement machinery still exists. This is supervised and administered by the IMF, which is still the essential instrument of international monetary coordination. In recent years the IMF has constantly increased its resources, particularly since the introduction of SDRs in 1968. After the sixth increase in quotas on 1 April 1978, the credits at the disposal of the IMF amounted to 39,000 million SDRs (48,000 million dollars), broken down as follows :

- United States .... 21.5 %
- EEC .... 27 %
- OPEC countries .... 10 %
- Developing countries .... 20.9 %
- Other industrialized countries ...... 16.8 %

The new majority required for IMF Board decisions is 3/5ths of the members (with 15% of the quotas constituting a blocking minority).

At the meeting of the Interim Committee of the IMF Board of Governors in Mexico on 29 and 30 April 1978, the possibility of a seventh increase in quotas and general use of SDRs was discussed.

There is a move towards a rule under which the old 25% gold tranche would be paid in SDRs. This raises the problem of the return on net holdings in SDRs, the right to hold SDRs and the creation of a real SDR market. In order to prevent the growth of international liquidity that would result from the quota increases, the beneficiaries of new SDR allocations (particularly the developing countries) could undertake to pay the equivalent into a consolidation account in dollars or a reserve currency. This matter is at present being studied by the IMF.

The consequences and risks of the present monetary situation

The criticisms which the operation of the IMF at present gives rise to relate mainly to the fact that the IMF acts pragmatically rather than following any clear-cut policy.

Thus, quotas are often increased for political reasons, and the unsystematic creation of SDRs can lead to a permanent temptation for some countries to remedy, or defer remedying, structural imbalances in this way.

As the role of SDRs and their position in international liquidity and foreign exchange reserves become more important, the IMF Board will have to pursue a rigorous policy on quotas, basing itself on objective economic data, as was attempted when the IMF was set up.

The general floating of currencies without any reference at all has more serious consequences.

Some members of the Section consider that floating makes possible automatic adjustment of exchange rates in line with the depreciation or appreciation of the currencies resulting from the economic policies pursued. In their view floating is therefore a liberal mechanism that through a series of balancing effects, give rise to adjustments compensating for the domestic depreciation or an appreciation of currencies, it produces the normal consequence of inflationary situations. A country which has more severe inflation than its trading partners will see its currency depreciate on the foreign exchange market, which will lead to automatic compensation enabling it to maintain its exports and reduce its imports.

According to the supporters of this theory, the only way to control exchange-rate fluctuations is to take economic policy measures that will combat inflation and balance of payments disequilibria and hence the domestic depreciation of the currency. A suitable economic policy is therefore the necessary precondition for a return to a system of stable exchange rates (possibly with periodic adjustment).

Against this theory it may, however, be argued that disorderly floating has numerous drawbacks.

First of all, it creates uncertainty in commercial contracts and is liable ultimately to affect these transactions and hence the development of international trade. This is all the more serious since international contracts for major items of equipment such as ships, aircraft, industrial plant, conventional and nuclear power stations, port installations, and even certain contracts for the supply of energy or raw materials, extend over a number of years.

On top of the risks that firms or States normally take when they conclude such contracts, there are exchange risks against which it is difficult or expensive to secure protection.

Disorderly floating also leads to excessive appreciation or depreciation of certain currencies, resulting in export or import difficulties and abnormal economic imbalances.

Furthermore, certain countries may be tempted to use the depreciation of their currency as a way of strengthening their competitive position or stimulating economic activity.

Floating may form an easy way out, at least temporarily, for certain States. These States believe that floating relieves them of the need to act early to defend their currency and restore their balance of payments equilibrium.

Before exchange-rate adjustments have even been able to have any balancing effect, inflation will have been fuelled by the rise in import prices and by currency speculation by economic operators seeking to hedge against exchange risks or to anticipate future exchange rates. This speculation may take the form of delaying the repatriation of foreign exchange resulting from commercial transactions or of capital transfers subsidiaries within a multinational group.

These operations are facilitated by the existence of large volumes of liquidity which further aggravate the anarchy and the risks by encouraging large-scale operations that may lead to certain currencies being hit for more or less subjective economic or political reasons (acceleration of price increases, social trends, political uncertainty, etc.). The countries in question have no effective defence against these operations, since corrective action takes time to work through.

The harmful effects of the current international monetary anarchy are further aggravated within the EEC.

Exchange-rate fluctuations and the lack of any monetary standard reflect the absence of economic solidarity in the Community and form barriers to the freedom of movement established by the Treaty of Rome. Cooperation between the Member States is also hampered.

The Common Agriculture Policy is a case in point. In 1962 a money of account was created for transactions in farm produce. This was the agricultural unit of account, in which farm prices were fixed. In 1969 exchange rate distortions led to the decision to introduce monetary compensatory amounts to offset currency fluctuations. This mechanism is liable to be ineffective in the case of rapid and large fluctuations, such as occurred at the beginning of 1978, thus jeopardizing the Common Agricultural Policy and the free movement of farm produce that forms one of the pillars of the Community.

The Treaty provides for a common commercial policy towards third countries. It is with this in mind that the Community has engaged in the GATT negotiations in Tokyo and Geneva (to be completed shortly). One may ask whether there is any point in negotiations on average protective rates of 8%, when it is known that exchange rate variations may far exceed that percentage in several months or in several weeks. It is clear that in this context agreements with third countries are pointless and that no common commercial policy is possible, although it is now more than ever necessary for the EEC to formulate such a policy towards its trading partners.

II. THE REQUIREMENTS FOR RETURNING THE INTERNATIONAL MONETARY SYSTEM TO NORMAL

The aims of a policy for a return to normal

The monetary system cannot be expected to solve economic problems by itself and remedy the imbalances which have often been at the root of monetary disparities.

The value of a country's currency is not unrelated to that country's economic situation without, however, being an exact reflection thereof. This is why it is possible and necessary to formulate a monetary policy (like a policy on prices, incomes and credit), which in turn has a bearing on economic policy.

It is therefore vital to conduct a suitable economic policy in parallel with monetary policy, so that the latter can produce a certain measure of certainty in international commercial transactions and does not contribute to any aggravation of economic disequilibria (inflation, balance-of-payments deficits or surpluses).

There are two requirements : a progressive return to parities which are stable but adjustable in the light of countries' economic situations, and a normalization of capital movements.

This incidentally was the aim of the Jamaica Agreement of January 1976, which provided for the subsequent introduction, by a qualified majority of 85%, of a system of stable but adjustable par values defined in SDRs or any other common denominator chosen by the IMF (but not gold or a currency) and with a fluctuation margin of 4.5%.

The means of achieving a return to normal

This is a medium or long-term aim. The return to more stable par values, which will at all events be a gradual process, is impeded by two major difficulties :

- the lack of any international monetary authority capable of enforcing the regulations laid down and, where necessary, of applying sanctions for undisciplined behaviour. Will the IMF be capable of playing this role, after it has shown itself to be unable to act in the past? At any rate the Jamaica Agreement laid down the principle that the IMF is to supervise par values and is to be able to veto any par value change it considers to be unjustified;

- the lack of any monetary reference standard. Here the role previously played by gold and the dollar could be taken over in theory by either a unit of account defined by a basket of currencies (the Jamaica Agreement suggests the SDR) or another national currency (this solution was ruled out by the Jamaica Agreement, and in any case which currency would this be?) or any other reference unit (one based on commodities has been suggested).

These are political rather than technical problems, although the technical aspects are important. It is unlikely that early international agreement can be reached on these problems, mainly because of the differences between national rates of inflation.

Accordingly, it would be more realistic to aim at concerted international action to minimize excessive fluctuations in exchange rates and control to some extent the floating of currencies or groups of currencies, as has been done under the "snake" agreement. The possibility has been mooted of forming a dollar-German mark-Yen "snake" (which should be extended to embrace a Community currency). In this way areas of relative currency stability could be created and gradually expanded.

But the joint floating of currencies is in fact only possible between those countries which have similar economic policies.

It also presupposes a common will to defend par values by all appropriate technical means, such as intervention by central banks, variation of interest rates, swap agreements, etc., although it must be recognized that these means are not very effective in the face of the heavy speculation in certain currencies, in which growing international liquidity has been an important contributing factor.

If any evidence is needed it is sufficient to point to the fact that over the past few months the defence of the dollar has necessitated the doubling of the dollar - German mark swap agreements from 2,000 million to 4,000 million dollars and the sale by the United States to the Bundesbank of SDRs for 740 million dollars, with the known outcome. From September 1977 to February 1978 the Bundesbank acquired more than 6,000 million dollars, while the Federal Reserve Bank devoted only 1,500 million dollars to the defence of the US currency.

The second requirement for re-establishing international monetary order is a return to normal in capital movements. This means first of all limiting the inordinate increase in currency (and Euro-currency) liquidity and if possible gradually reabsorbing this liquidity.

As a result of the deficit on the US balance of trade, 60,000 million dollars are added annually to this liquidity (in February 1978 alone, this deficit rose by 4,500 million dollars).

The seigniorage attaching to the dollar can be threatened only by exporters to the United States, who could refuse to accept payment for their exports in dollars. But although such action is being contemplated (particularly by OPEC countries) this is not a very realistic possibility at the present time. But an agreement might perhaps be reached with the United States on a solution to this situation. A return to equilibrium in the United States trade balance seems, however, rather uncertain in the medium term, when one considers the difficulties President CARTER is having in getting his energy conservation plan accepted.

There also arises the question of the reimbursement or consolidation of the dollar holdings of non-US residents (Euro-dollars or petro-dollars), which amount to almost 350,000 million dollars. An agreement with the United States on this subject is essential, although no solution is in sight. The idea has, however, been put forward of converting these holdings into SDRs within the IMF framework or of investing them on the US capital market (for example, by buying shares in American companies).

Such operations would have the advantage of stabilizing the international capital market and of limiting the scope for foreign exchange transactions which are not connected with commercial settlements but which anticipate monetary fluctuations and increase such fluctuations.

Within the context of an international settlement there also arises the problem of the growing indebtedness of the non-oil-producing developing countries, and the settlement of their debts, which often exceed their ability to pay. (Third World indebtedness to industrialized countries is currently put at 250,000 million dollars, with the public debt alone amounting to 170,000 million dollars). This problem was raised by the group of 77 developing countries at the UNCTAD ministerial meeting in Geneva in March 1978, but no solution could be found that was acceptable to the industrialized countries. Some of the latter came out in favour of at least a partial remission of debts, while others give preference to stabilization of raw material prices. Will the next UNCTAD conference, which is to be held in Manila in 1979, propose solutions?

III. THE ROLE OF THE EUROPEAN ECONOMIC COMMUNITY IN MOVES TOWARDS A RETURN TO NORMAL

The EEC, like the rest of the world, is subject to the harmful effects of the present international monetary disorder. Can it play an active part in moves towards a return to normal?

It could set itself the task of first of all controlling the exchange-rate fluctuations between Member States' currencies. Its second aim should be to work out a concerted policy for helping to restore the international monetary system to normal.

Within the EEC

Despite the lack of progress towards economic and monetary union, it is necessary to continue efforts to advance the harmonization and coordination of the Member States' economic policies. Without being a necessary precondition, this could greatly facilitate the normalization of currency relationships (the same also applies to short and medium-term economic policies, tax harmonization, social harmonization, the common commercial policy, etc.).

The Copenhagen summit meeting, which dealt broadly with this reform of the EMCF, gives grounds for hopes that may take on concrete shape at the next meeting of the Heads of Government in Bonn in July next.

Some members consider that this reform could be carried out in two stages :

- In the first stage, the EMCF should be able to intervene to defend the par values of Community currencies by multilateralizing swap agreements and by intervening on the exchange market with currency or SDR credit lines. (The figure of 20,000 million dollars has been mentioned as the volume of credit needed for effective intervention). Credits would be granted under the supervision of the Council of Ministers in accordance with specific rules concerning changes in exchange rates, and interest rate policies. The economic situation in the countries concerned would also be taken into account.

- In the second stage, the EMCF could itself grant credits by a qualified majority vote of its board, in the light of the economic situation in the borrowing countries. Thus the EMCF could act as a kind of IMF at Community level by, for example, vetting proposed changes in the par values of the currencies in the European "snake".

Other members, however, doubt whether it would be wise to use a qualified majority vote as the basis for granting credits since, if this happened, there would be a danger of countries with balance-of-payments deficits making excessive use of credits. The fact that very short-term EMCF assistance is already automatic, i.e. is not voted on in any way, does not in itself suggest that it would be expedient to apply the qualified majority principle for medium-term assistance. These same members also point out that the number of votes allotted to each country in the IMF is determined by its quota, and this quota system is the basis for the granting of credit.

In order to pave the way for the introduction of a parallel currency that would not be limited to the public authorities, it would be desirable to encourage use within the Community of the European unit of account for commercial contracts and loans. Industry and trade would have to be briefed thoroughly beforehand for this to be possible.

Within the international monetary system

Its domestic monetary policy having been defined, what role can the Community play in the moves to restore normal conditions in the international monetary system?

First of all, it should assert a common position in the international monetary institutions, especially the IMF, where the Member States as a whole carry considerable weight and have 25% of the votes, i.e. a blocking minority enabling the Community to exert considerable influence on IMF policy, vis-à-vis the other monetary blocs, particularly the USA. The political will for this will have to be mustered.

From a strengthened position, the Community should engage in bilateral negotiations - or negotiations within the IMF framework - with the USA aimed at finding a solution to the problem of the consolidation of the dollar balances held by Member States, so as to enable these assets to be invested on the US capital market, for example.

Multilateralization of swap agreements - with the EMCF acting as intermediary - so as to include the other monetary blocs (dollar or yen) would also make for better protection of par values and a return to a greater degree of fixity in exchange rates throughout the world.

The Community should also act as such to control short-term capital flows, for example, by international coordination of interest rate policy and by laying down a code of conduct for multinational enterprises in particular.

In this connection, it would be expedient to implement Article 72 of the Treaty of Rome, which provides as follows :

> "Member States shall keep the Commission informed of any movements of capital to and from third countries which come to their knowledge. The Commission may deliver to Member States any Opinions which it considers appropriate on this subject."

Finally, the Member States should take concerted action within the IMF on supervision of the creation of international liquidity (in SDRs, dollars or Euro-currencies). The aim should be to control the excessive growth of this liquidity through a common position vis-à-vis the responsible authorities.

IV. CONCLUSION

The measures proposed can facilitate a return to a certain degree of normality in the international monetary situation in the short or medium term. The Community must not abandon the objective of complete economic and monetary union, in spite of the failures and setbacks. In the present international monetary disorder, the EEC should gradually form an "area of stability", which would help in restoring world monetary equilibrium.

The ESC will continue its work in this field, examining other aspects of economic and monetary union with the aim of determining the requirements for the creation of a common currency which can help restore equilibrium to the international monetary system.

A P P E N D I C E S

Appendix 1

TABLE OF MAIN MONETARY EVENTS

July 1944	- Bretton Woods Conference
1946	- Setting up of the IMF with 44 members
1950	- Creation of the European Payments Union
1952	- Decision of the IMF on the gold tranche
1955	- Belgium introduces the two-tier exchange market
1958	- Setting up of the EEC Monetary Committee
1963	- Compensatory finance
8 May 1964	- EEC Council decision on cooperation between Member State central banks and prior consultation on parity changes
September 1968	- Decision to introduce SDRs
	- The Basle agreement settles the problem of sterling balances
1969	- Conference at The Hague lays down the principles of European economic and monetary union
1970	- Approval of the Werner Plan
9 February 1970	- Introduction of short-term monetary support between EEC central banks

March 1971	- The EEC Council lays down the timetable for EMU
15 August 1971	- The United States suspends the convertibility of the dollar
December 1971	- The Smithsonian Agreement
Beginning of 1972	- Gold hits 50 dollars an ounce
24 April 1972	- Birth of the European "snake"
June 1972	- Sterling floats
Summer 1972	- The IMF sets up the Committee of Twenty (including several developing countries) to prepare a reform of the international monetary system
January 1973	- Floating of the pound
February 1973	- New surge of world speculation against the dollar - new devaluation of the dollar from 38 to 42.22 dollars an ounce of gold
	- Japan and Switzerland decide to allow their currencies to float
March 1973	- The countries of the "snake" agree to allow their currencies to float against the dollar. The "snake" leaves the "tunnel"
April 1973	- Creation of the European Monetary Cooperation Fund (EMCF), administered by the Bank for International Settlements
September 1973	- Meeting of the Committee of Twenty in Nairobi - Laying down of new monetary rules

October 1973 } November 1973 }	- Energy crisis - oil prices quadrupled
January 1974	- The French franc leaves the "snake"
April 1974	- Meeting in Zeist of EEC Ministers of Finance, who decide to free gold transactions
June 1974	- Meeting of the Committee of Twenty, which decides that central banks can mortgage their gold assets on the basis of the free-market rates
28 June 1974	- The IMF decides that the SDR will be fixed in terms of a basket of currencies and raises the interest rates on SDRs
January 1975	- The gold holdings of the Bank of France are revalued
Early 1975	- The United States re-opens the gold market
10 July 1975	- The French franc rejoins the European "snake"
August 1975	- Agreement of the Group of Ten on gold
31 August 1975	- Meeting of the Interim Committee of the IMF in Kingston Revision of the Articles of Agreement of the IMF - Sixth revision of the quotas

<u>September 1975</u>	- Meeting of the IMF The Group of Ten decides that the central banks can buy and sell gold at the market price on condition that they buy only from the IMF or other central banks (the IMF will keep two-thirds of its gold) - Across-the-board increases of quotas
<u>November 1975</u>	- Franco-American declaration at Rambouillet on the question of exchange rate stabilization
<u>December 1975</u>	- Publication of the Tindemans Report on European Union
<u>7/8 January 1976</u>	- The Jamaica Agreement makes SDRs the pivot of the international monetary system
<u>March 1976</u>	- The French franc leaves the European "snake"
<u>Early 1978</u>	- Seventh revision of IMF quotas
<u>1 April 1978</u>	- The Jamaica Agreement comes officially into force
<u>29/30 April 1978</u>	- Meeting of the Interim Committee of the IMF in Mexico - Study of how to increase IMF funds.

Appendix 2

EUROPEAN UNITS OF ACCOUNT

The European Communities use various units of account in the major sectors of activity.

1. The gold-parity unit of account, like the old dollar parity, has a reference weight of 0.88867088 grams of fine gold. Because of the big changes in exchange rates since 1969 the gold-parity unit of account no longer accurately reflects exchange relationships between the different currencies on the market. But it is still used in some areas of Community activity such as Common Customs Tariff transactions and the Generalized Preferences Scheme for developing countries (e.g. if US tobacco, which is not subject to an ad valorem duty, is imported through Genoa it pays 60% less duty than if it is imported through Hamburg because duties are expressed in gold-parity units of account and the conversion rates into national currencies differ from actual market rates). Until the end of 1977 the gold-parity unit of account was also used for Community budget transactions.

2. <u>The agricultural unit of account</u> too is officially defined as the value of 0.88867088 grams of fine gold. But in practice prices laid down in agricultural units of account are converted using representative rates, which apply only to agriculture. Discrepancies between these so-called "green conversion rates", which are normally fixed each year by the Council, and actual market rates are covered by the Monetary Compensatory Amounts (MCAs). The agricultural unit of account is tied to the currencies of the Member States in the "snake" (West Germany, the Benelux countries and Denmark), so that MCAs are paid only to the other Member States.

3. <u>The European Monetary Unit of Account</u> (EMUA) has the same fine gold value as the other two units. It is only used for transactions of the European Monetary Cooperation Fund. The central banks of the "snake" countries use it for settling claims and liabilities arising out of their currency market dealings. The fact that such amounts are calculated in EMUA constitutes an exchange guarantee and enables credit and debit positions vis-à-vis the Fund to be settled on a multilateral basis.

4. <u>The European Unit of Account</u> (EUA) is based on a basket of fixed amounts of the currencies of the nine Member States. The first step in working out its value is to weight the individual currencies in the basket. This is done by taking the average value of each country's GNP and foreign trade over the period 1969-1974, which gives the following percentage weightings for each currency :

- DM	:	27.3 %
- FF	:	19.5 %
- £	:	17.5 %
- Lit.	:	14.0 %
- Hfl	:	9.0 %
- FB/FLux	:	8.2 %
- DKr	:	3.0 %
- £ Ir	:	1.5 %

The starting value of the EUA was fixed on 28 June 1974, the same day as the SDR basket, and like the SDR was set at 1.2 US dollars.

The value of the EUA is found by adding together 3.66 FB, 0.14 FLux, 0.828 DM, 0.286 Hfl, £0.0885, 0.217 DKr, 1.15 FF, 109 Lit. and £ Ir. 0.00759.

The value of the EUA in each of the national currencies below is found by adding up the value in local currency of each of the currencies making up the basket as officially listed on the local currency markets, which are :

Frankfurt	for the German Mark
Copenhagen	for the Danish Krone
Amsterdam	for the Dutch Guilder
Paris	for the French Franc
Rome/Milan average	for the Italian Lira
London	for the pound sterling
Dublin	for the Irish pound
Brussels	for the Belgian Franc

The value of the EUA changes in the light of the weighted exchange rate movements of all the basket currencies. Thus the impact of big changes in the values of individual currencies on the EUA is lessened.

The EUA is already used for a wide range of Community business.

a) <u>The European Development Fund</u>

In the Council Decision of 21 April 1975 it was laid down that development aid paid out under Article 42 of the Lomé Convention would be expressed in EUA. Consequently, recipients who have to use their aid to make purchases in the EEC Member States are not at the mercy of sudden fluctuations in the value of an individual currency; the value of their aid depends on the average trend of all the Member States' currencies, so that there is a certain measure of security. At the same time, donor countries are obliged to provide a certain level of aid in real terms.

b) <u>The ECSC</u>

In December 1975 a Commission Decision, which was fully supported by the Council, made it compulsory to use the EUA for ECSC transactions.

The production levies, which finance some 80% of the ECSC budget, are expressed in EUA as a fixed percentage (0.29%) per unit of production and then converted into national currencies. This ensures that firms in different Member States with the same output pay the same levy and that a competitive advantage is not gained through tax rates being different.

ECSC expenditure, which goes mainly on research and development work in the coal and steel industries, and accounts are also denominated in EUA.

When market conditions are suitable the ECSC can grant loans, but this has not been done to date.

c) <u>The European Investment Bank</u>

Following the Board of Governors' decisions of 18 March 1975 and 10 November 1977, the European Investment Bank now uses the EUA when drawing up its balance sheet.

d) The Community Budget

In April 1976 the Council approved the Commission's intention to use the EUA in the Community budget from 1978 onward and do away with the existing gold-parity unit of account. The Commission was given until the end of March 1978 to draw up an Implementing Regulation for using the EUA, so that from that date on the daily conversion rate could be used for both budget receipts and expenditure.

Using the EUA will make no difference to receipts that come from the Community's resources, but it will ensure greater fairness when Member States' contributions are worked out in national currencies.

It will not be possible to use the EUA for all items of expenditure in the budget. There will be no problem using it for expenditure that only the Community alone can determine, such as subsidies. Similarly, when the Community purchases goods or services its strong position as a major customer will probably ensure that it is billed in EUA. The EUA's attractiveness when compared with national currencies will play a significant role in such transactions.

But small-scale purchases of goods etc. will in future be expressed in both EUAs and the relevant national currency.

Doing away with the gold-parity unit of account has made it easier to keep track of budgetary receipts and expenditure and led to the disappearance of the discrepancies that used to occur when, for example, ceilings were placed on the cost of government orders or fines were laid down by the European Court of Justice. The amounts concerned sometimes used to vary by as much as 50% depending on whether the current market exchange rate or the theoretical exchange rate of the old unit of account was used.

e) <u>Other Areas</u>

A number of Council Directives involve using the EUA. Worth mentioning are those on the minimum amount of liability capital to be held by insurance companies and the publication of government orders over a certain amount in the Official Journal of the European Communities.

At the end of 1977 the Community's medium-term financial aid was expressed in EUA. All credit granted out of this aid to countries with balance-of-payments difficulties and the interest payments involved are concerted into EUA.

Financial transactions with non-member countries are increasingly being expressed in EUAs.

B. OPINION OF THE ECONOMIC AND SOCIAL COMMITTEE ON THE COMMUNITY APPROACH TO THE PRESENT INTERNATIONAL MONETARY DISORDER

1. General Considerations

The Committee considers that the value of a country's currency is not unrelated to that country's economic situation without, however, being an exact reflection thereof. While the monetary system cannot be expected by itself to counterbalance serious economic disturbances which inevitably have an effect on exchange rates, it is nevertheless vital to coordinate economic and monetary policies. It is with this in mind that the Committee has discussed the matter under review and is now proposing guidelines designed to restore economic and monetary equilibrium.

2. The Present Monetary Situation

The Worldwide Situation

International currency relationships are based at present on a number of factors of varying importance. The main factors are :

- a system of short-term credit, inherited from th
  Bretton Woods Agreement, and operated by the
  International Monetary Fund (IMF). Nearly all t
  countries of the world, apart from the majority
  the State-trading countries, are members of the

- the dominant position of the United States dolla
  this is not convertible into gold at a fixed rat
  but is still widely used as a reserve currency b
  the central banks and as money of account or set
  ment for international transactions. As a resul
  the United States can pay for its imports - and
  particular its oil imports - in its own currency
  without having to suffer any consequences of a
  balance-of-payments deficit;

- the absence since 1971 of any generally accepted
  monetary standard and of any mandatory rules gov
  ning the rates of exchange between currencies
  (general floating). This has led in recent year
  to serious disturbances in exchange rates, despi

- the appearance of a new monetary reference unit : the Special Drawing Right (SDR), which is a new form of international liquidity;

- widespread de facto convertibility and the disappearance of exchange controls on current account transactions, at least in those countries which account for the bulk of world trade;

- a very uneven distribution of exchange reserves between countries, some of which have an excessive debt burden;

- a large volume of international liquidity held either by the central banks (estimated at 249,000 million SDRs or 270,000 million dollars at the end of September 1977), or by economic operators in the form of "Euro-currencies"; this liquidity is being expanded in the main by the united States balance-of-payments deficit and also, to a lesser degree, by other countries' deficits.

The Situation in the European Economic Community

These features are also found in the European Economic Community, where currency relationships are likewise based on the following de facto or de jure factors;

- convertibility of all the EEC currencies;

- machinery for offsetting claims and liabilities and a short-term credit system, operated by the European Monetary Cooperation Fund (EMCF);

- the agreement entered into by the members of the EEC in April 1972 not to allow their exchange rates to fluctuate more than 2.25% against each other. Only five of the nine Member States are still participating in the joing float - the "snake" - introduced under this agreement; the others either have never participated or have withdrawn;

- considerable disparities in the volume of exchange reserves held by the various Member States, and the worsening of exchange-rate divergences between some currencies;

- use by the Community Institutions and the Member States of different units of account which act as common denominators for evaluating the national currencies, and are linked to the latter by conversion rates (the European Monetary Unit of Account (EMUA), the Agricultural Unit of Account and the European Unit of Account (EUA), the value of which is determined every day on the basis of a basket of Community currencies).

3. The Effects and the Dangers of the Present Monetary Situation

The International Position

The criticism now levelled at the way the IMF operates relates essentially to the absence of a clear-cut policy, i.e. it operates pragmatically.

Thus, quotas are often expanded under pressure from certain countries, and there may be a permanent temptation to create SDRs in order to remedy, or postpone remedying, structural imbalances.

The fact that many currencies are <u>floating freely</u> has had more serious effects :

- lack of security in international transactions, which leads economic operators to cover themselves against exchange risks and even anticipate future exchange rates;
- excessive appreciation or depreciation of the currencies of some countries, resulting in export or import problems and abnormal economic imbalances;
- tendency for certain governments to take what seems to be an easy way out - at least temporarily; these governments believe that there is no need for them to act early to defend their currencies or restore their balance-of-payments equilibrium;
- a temptation for some countries to deliberately let their currency depreciate so as to stimulate economic activity or strengthen their competitive position, and in this way increase their exports and reduce their imports;

- reinforcement of inflationary tendencies.

Lastly, the disorder and dangers of the present situation are further aggravated by the existence of large volumes of liquidity. This encourages large-scale operations that may result in certain currencies being hit for more or less subjective economic or political reasons (acceleration of price increases, social trends, political uncertainty, etc.). The countries in question have no effective defence against these operations, since corrective action takes time to work through.

The Position within the European Economic Community

The harmful effects of the current international monetary disorder are reflected in the EEC and are jeopardizing the common market.

The exchange-rate fluctuations and the lack of any monetary standard show the absence of economic solidarity in the Community, and form barriers to the freedom of movement established by the Treaty of Rome. Cooperation between the Member States is also hampered.

The protection afforded by the common external tariff (average rate of 8%) is in danger of being cancelled out by the present wide fluctuations of exchange rates, which make agreements with non-member countries under the auspices of GATT ineffective.

Despite the system of compensatory amounts which has had to be introduced to permit its operation, the Common Agricultural Policy is feeling the effects of repeated and ever growing monetary upheavals.

4. The Requirements for Returning the International Monetary System to Normal

The Aims of a Policy for a Return to Normal

The monetary system cannot be expected to solve economic problems by itself and remedy the imbalances which have often been at the root of monetary disparities. Nevertheless :

- it must ensure a degree of security in international commercial transactions, and

- it must not make the imbalances worse (inflation, recession, unemployment, balance-of-payment deficits and surpluses).

There are two requirements for achieving this; a gradual return to exchange rates which are stable but adjustable in the light of countries' economic situations, and a return to normal in movements of capital.

The Means of Achieving a Return to Normal

There are two major difficulties in the way of a gradual return to more stable par values :

- the inadequacy of the rules laid down and the lack of any international monetary authority capable of enforcing them (as the IMF used to do) and, where necessary, of applying sanctions for undisciplined behaviour;

- the lack of any monetary reference standard. Here, the role previously played by gold and the dollar could be taken over in theory by other standards.

These two points are political rather than technical problems. It is unlikely that an early international agreement can be reached on them, mainly because of the differences between national rates of inflation.

Accordingly, it would be more realistic to aim at concerted international action in order to minimize excessive fluctuations in exchange rates and provide some control over the floating of currencies or groups of currencies (as in the case of the European "snake"). In this way areas of relative currency stability could be created and gradually expanded.

The joint floating of currencies is, in fact, only possible between those countries which have similar economic policies.

Joint floating also presupposes a common political will to promote the stabilization of exchange rates by all appropriate technical means, such as :

- intervention by the central banks;
- coordinated variation of interest rates;
- swap agreements.

It should, however, be recognized that these means are not always effective in the face of the heavy speculation in certain currencies, in which the increasing international monetary liquidity is an important factor.

The second requirement for re-establishing international monetary order is the prevention of speculative movements of capital by limiting the inordinate increase in currency (and Euro-currency) liquidity and, if possible, gradually reabsorbing this liquidity under an overall agreement with the United States on the repayment or consolidation of dollar holdings (almost half of which are in the hands of the central banks), and on future changes in this liquidity.

In the immediate future, the monetary authorities of the countries in question will have to take concerted action to limit the undesirable effects of foreign exchange transactions which are not connected with commercial settlements or investments and which anticipate monetary fluctuations, increase such fluctuations and jeopardize monetary policy.

There is also the problem of the growing indebtedness of the non-oil-producing developing countries and the settlement of their debts, which often exceed their ability to pay. (Third World indebtedness to the industrialized countries is currently put at 250,000 million dollars).

5. The Role of the European Economic Community in Moves towards a Return to Normal

The EEC, like the rest of the world, is subject to the harmful effects of the present international monetary disorder. Can it play an active part in moves towards a return to normal?

The Committee believes that the Community's first aim should be to reduce the exchange-rate fluctuations between Member States' currencies. Its second aim should be to work out a concerted policy for helping to restore the international monetary system to normal.

Such a policy might embrace the following :

Within the EEC

Promotion of a strategy for aligning and coordinating economic policies which (without being an essential precondition) could help to restore relationships between Member State currencies to normal.

Improvement in the consultation and decision-making procedure of the EEC bodies responsible for monetary questions (the Monetary Committee, the Committee of Central Bank Governors, etc.) and, if necessary, extending their areas of responsibility and their powers of initiative to enable them to make an effective contribution to the drawing up and implementation of a Community monetary policy.

Maintenance of the present European "snake" for the participating currencies. The other Community currencies should (re)join the "snake" within a reasonable period. To this end, transitional arrangements should be devised for these currencies. Account should be taken here of different inflation rates, while at the same time efforts should be made to reduce inflation at both Community and national level.

Permanent cooperation between the central banks and the monetary authorities for the purpose of identifying and curbing short-term capital flows (e.g. by adjusting interest rates).

If these aims are to be achieved, it will be necessary to reform the European Monetary Cooperation Fund (EMCF), whose resources, authority and areas of responsibility will have to be increased so that it can take effective action.

In the immediate future, the EMCF could act in the defence of par values by multilateralizing swap agreements and by intervening on the European exchange market with currency or SDR credit lines. This would enable it to play a stabilizing role under the supervision of the Council of Ministers, which should draw up rules to be observed by the EMCF and the national monetary authorities with regard to :

- parity changes,
- the conditions for granting credit, and
- interest rate policy.

The EMCF board would in future make an annual review of each Member country's economic and financial situations, paying due regard to the code of conduct laid down by the Council of Ministers. Where an application is made for credit the country in question would have to give the EMCF every guarantee that its intended policy is in keeping with the Council's decisions on the convergence of economic policies. The EMCF would then grant its credits with due regard to the economic and financial policies of the applicant country. The EMCF would take its decisions on the granting of credit by a qualified majority based on the Member States' quotas, and in accordance with rules still to be established.

The EMCF would thus perform at Community level functions similar to those of the IMF.

Encouragement should be given to use of the EUA as money of account for intra-Community business transactions. Industry and trade would have to be briefed thoroughly beforehand for this to be possible.

Within the International Monetary System

Assertion of a common EEC position in those international monetary institutions in which the EEC countries together carry considerable weight (for instance, the IMF) and of a common attitude towards non-member countries and other monetary blocs.

Opening of negotiations with the United States aimed at consolidating the dollar balances held by Member States, particularly by encouraging the import of capital by the United States.

Multilateralization of swap agreements, so as to include the other monetary blocs (dollar or yen). If there is no concerted action on the fixing of interest rates, however, care should be taken to ensure that this mechanism does not have any adverse effects.

Channelling of short-term capital flows, for example by international consultation on interest rate policy and by drawing up a monetary code of conduct for multinational enterprises in particular.

Adoption of a common EEC position with regard to the indebtedness of the developing countries.

Concerted action on the part of the Member States within the IMF to vet the creation of international liquidity (in SDRs, dollars or Euro-currencies).

6. *Conclusion*

The measures proposed can facilitate a return to a certain degree of normality in the international monetary situation in the short or medium term. The Community must not abandon the objective of complete economic and monetary union, in spite of the failures and setbacks. In the present international monetary disorder, the EEC should gradually form an "area of stability", which would help in restoring world monetary equilibrium.

The ESC will continue its work in this field, examining other aspects of economic and monetary union with the aim of determining the requirements for the creation of a common currency which can help restore equilibrium to the national monetary system.

European Communities - Economic and Social Committee

"Community Approach to the Present International Monetary Disorder"

Opinion of the Economic and Social Committee

Brussels : General Secretariat of the Economic and Social Committee

1978 - 98 pages
DK, D, E, F, I, N.

*

In order to minimize the harmful effects of the present international monetary disorder, and achieve its principal task of reducing the exchange rate fluctuations between Member States' currencies, the Community must increase the resources, authority and area of responsibility of the European Monetary Cooperation Fund (EMCF). The Committee believes that the EMCF should act as a kind of IMF at Community level.

*

ECONOMIC AND SOCIAL COMMITTEE
Press, Information and Publications Division

Rue Ravenstein 2
1000 BRUSSELS

Tel. 512 39 20
513 95 95

Telegrams : ECOSEUR
Telex : 25 983 CESEUR