

COMMISSION OF THE EUROPEAN COMMUNITIES

COM (75) 438 final

Brussels, 25 July 1975

COMMUNICATION FROM THE COMMISSION TO THE COUNCIL
Effects of developments in the international monetary situation on
the working of the European Development Fund

COM (75) 428 final

COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

Subject : Effects of developments in the international monetary situation on the working of the European Development Fund.

The developments which have taken place in the international monetary situation since 10th May 1971 (the date of the floating of the German Mark and the Dutch florin) have created serious problems in the administration of the E.D.F.

In order to understand the nature of these problems it is essential to bear in mind the texts of the following documents which are or were applicable to the administration of the Fund :

- 1) Protocol N° 7 relating to the value of the unit of account
- 2) Article 3, paragraph 4, of the Internal Agreement relating to the financing and administration of Community aid
- 3) Article 2, paragraph 5, of the Financial Regulations of the EDF laid down in the Internal Agreement relating to the financing and administration of Community aid.

These texts are attached to the present Communication as Annexes 1 and 2

Protocol N° 7 defines the value of the unit of account and specifies the methods of calculating the various currencies of the Member States in relation to the unit of account.

Article 3, paragraph 4, of the Internal Agreement relating to the financing and administration of Community aid deals with the provision for an exchange guarantee for the Commission's credits representing the member States' contributions shown in the Treasury accounts of the member States.

Article 2, paragraph 5, of the Financial Regulations of the EDF describes the methods for the application of this exchange guarantee.

With regard to EDF operations, developments in the international monetary situation have given rise to four successive decisions :

- 1) the decision of 10th May 1971 of the German and Dutch governments to expand temporarily the fluctuation margins of their currencies,
- 2) the decision of 15th August 1971 of the U.S. Government to suspend sine die the convertibility of the U.S. dollar into gold (or into any other reserve asset) - this decision itself bringing about the floating as from 23rd August 1971 of the Belgian Franc, the Luxembourg Franc and the Italian Lira.
- 3) the decision taken on 18th December 1971 in Washington by the Group of Ten to constitute a new, stable international financial system either in the form of parities or in the form of a central rate and also to widen the fluctuation margins for the exchange rate of each of their currencies to 2.25 % either side of this central rate,
- 4) the decision taken subsequently by the Italian Government (on 14th February 1973) and by the French Government (on 21st January 1974) to allow the Italian Lira and the French Franc to float.

°
° °

The first sentence of Article 2 of Protocol N° 7 sets out the principle that the parity of a member State currency with relation to the unit of account is the relationship between the weight of fine gold corresponding to the parity of this currency as notified to the International Monetary Fund.

The second sentence, envisaging the hypothetical case in which the exchange rate of the currency in question was to differ from the parity by a margin greater than the authorised by the IMF (as happens when a currency floats)

specifies that it will then be necessary in such circumstances to calculate what weight of fine gold corresponds to the variation in the exchange rate and goes on to describe the method of calculation to be adopted : the weight of fine gold corresponding to the parity shall be calculated on the basis of the exchange rate used in the member State for current transactions on the day of the calculation in a currency directly or indirectly defined and convertible into gold on the basis of the parity notified to the IMF of this convertible currency.

The currency directly or indirectly defined and convertible into gold referred to in the last part of Article 2 was, in fact, the U.S. dollar which, until the date of the U.S. Government's decision, was the only currency to meet the two preconditions : direct or indirect definition and convertibility into gold.

After the U.S. Government's decision to suspend the dollar's convertibility into gold, the Commission staff found themselves confronted with a legal impasse. They no longer had a method by which to calculate the parity of the different floating currencies vis-à-vis the unit of account.

Faced with this situation they submitted to the financial experts of the member States numerous proposals for a solution which would enable them properly to administer the EDF.

None of the proposals formulated by the Commission staff received the unanimous approval of the member States who, for their part, were unable to produce any solution to the Commission authorities.

However, the need for a daily calculation of numerous transactions obliged the Commission authorities to agree on a procedure which may be summarised as follows :

- 1) for the period between 10th May and 15th August 1971 which is only concerned with the means of converting the German Mark and the Dutch florin into units of account , Article 2 of Protocol N° 7 applies, which had foreseen the need to relate the exchange rates of floating currencies to the U.S. dollar :

This was the only point upon which there was unanimity in the positions of the Commission and of all the member States.

- 2) for the period between 15th August and 18th December 1971 inclusive, following proposals from the Commission and counter-proposals from the German Delegation, agreement was reached between the Commission and the delegations of five member States to the effect that the exchange rates of member State currencies vis-à-vis the unit of account be calculated by reference to the movements of the exchange rates of the floating currencies against the only member State currency which was not floating, which, at that time, was the French franc.

Only Italy felt unable to agree to this.

- 3) for the period following 18th December 1971, the Commission put forward a proposal that the new central rates which had just been agreed at Washington should be considered as the new parities.

This proposal, however, did not obtain the unanimous approval of the member States : Italy, in particular, as from 18th December and after the devaluation of the dollar, continued to equate 1 unit of account with 1 U.S. dollar and to pay its contributions on the basis of the exchange rate of the Italian Lira against the U.S. dollar i.e. 1 U.S. \$ = 581.5 Lit.

- 4) for the period following 14th February 1973 (the floating of the Italian Lira) and 21st January 1974 (the floating of the French franc) the Commission has let it be known that it has adopted the following procedure :

- for the conversion into units of account of the non-floating currencies of the member States : the continuation of the former method,
- for the conversion into units of account of the floating currencies, the use of a rate based on the average of the exchange rates of all the currencies in the "snake" against the currency in question and as quoted on foreign exchange markets. This method is identical to that used for the ECSC unit of account as decided by the Commission Decision n° 3542/73 ECSC of 19th December 1973.

Italy and France never agreed to this method and paid their contributions as follows : France by reference to the parity of the French franc declared to the IMF, Italy by continuing to apply the exchange rate of the Italian Lira against the U.S. \$ of 1 U.S. \$ = 581.5 It.L.

Naturally, the Commission authorities accounted all EDF transactions - both commitments and payments - according to the procedures which they had adopted, that is to say as far as possible, and in the spirit of the provisions of Protocol N° 7 referring to the development of real exchange rates and not to totally outdated parities.

It was in this light, notably, that the Commission staff laid down the rules by which tenders submitted by the various MS companies for contracts financed by the EDF were to be judged. This enabled companies in those MS whose currencies were floating downwards to maintain their competitiveness vis-à-vis companies from MS whose currencies were firmer.

During this period, however, some receipts were cashed by the Commission on the basis of parities which no longer accorded with their real values, resulting in a loss to the treasury which, at present, is of the order of 30 m. units of account. This means, in effect, that the Commission staff are not in a position to guarantee the payment of the latest payment vouchers relating to EDF contracts :

Given this situation, the Commission proposes that two things be done :

- the first with the immediate aim of bringing the procedures for accounting of expenditure into line with those for the encashment of receipts so that the present deficit does not increase still further,
- the second, to put in order the past transactions between 10th May 1971 and 1st July 1975.

1. The steps to be taken immediately

On 1st July 1975 the MS are due to pay to the Commission the second part of their EDF contributions for the financial year 1975.

The Commission proposes to apply in advance, as from 1st July 1975, the basket-type unit of account decided upon on 21st April 1975 for operations under the Fund constituted under the Lomé Convention for the receipts and expenditures of the Funds now in being. As from the same date, the Commission authorities will cease to judge tenders and to account for expenditure according to the so-called ECSC method. Instead these will be based on the exchange rates resulting from the "basket" system.

If, as seems likely, the decision asked of the Council comes after the payment of the contributions due on 1st July, the Commission and the MS would then make the necessary adjustments retrospectively.

2. The steps to regularise the past

The deficit on 30th June 1975 must be covered. There are, in theory, four possible methods of doing this.

Method 1

To adjust all transactions on the basis of the Lomé "basket" type unit of account.

At the request of the member States' financial experts the Commission staff did a considerable amount of work recalculating about 350 transactions in member states currencies in this unit of account. The results show that if this method were to be adopted the Commission would receive only 13.5 m. units of account.

As a consequence this method would leave an outstanding deficit of around 16.5 m. units of account.

It cannot be envisaged that this deficit could be covered by drawing from the EDF balances a sum in addition to the existing commitments.

In the present state of the 1st, 2nd and 3rd EDFs, there is not in fact any uncommitted sum of this size.

The first method is, therefore, impracticable.

Method 2

Not to regularise the receipts, but to make up the deficit simply by acting on expenditure only.

Since all the available money of the 1st, 2nd and 3rd EDFs has been committed or reserved under the programming of the 3rd EDF, it would be necessary to reduce the credits allocated to those countries where the pace of execution has fallen behind schedule.

If it were considered more desirable to share the reduction between all the AASM, the application of this system would penalise those AASM whose speed of project execution was high, because it would inevitably lead to cuts in the projects for those countries.

In either case, it would mean that the AASM would be bearing the consequences of currency fluctuations of the MS.

This method is politically indefensible.

Method 3

To continue to balance the accounts which have just been criticized by the Control Commission, by including within them credits to be recovered as sums due from the MS.

This artificial method would mean that when the funds of the 3rd EDF passed to the 4th EDF the new MS would have to contribute to footing the bill.

Method 4

To put these receipts in order by using the same system as those used up to now for accounting for expenditure.

Although this method would mean a very heavy burden for Italy and a rather lighter one for France, the Commission considers that it is the only method which is compatible with the principle of equality between the contributions of the MS and which respects the spirit of the commitments made to the Associated States.

Accordingly the Commission proposes that the Council asks the member States and the Commission to apply this method by the adoption of the Gentlemen's Agreement, the text of which is attached hereto as Annex 3.

9

Annex 1

PROTOCOL N° 7

concerning the value of the unit of account

The High contracting parties

Have agreed upon the following provision, which are annexed to the Convention :

Article 1

The value of the unit of account used to express sums in the Convention of Association or in the provision adopted in implementation of this Convention shall be 8.88867088 grams of fine gold.

Article 2

The parity of the currency of a member State in relation to the unit of account defined in Article 1 shall be the relation between the weight of fine gold contained in this unit of account and the weight of fine gold corresponding to the parity of such currency as declared to the International Monetary Fund. Should there be no declared parity, or should the rates of exchange applied to current payments differ from the parity by a margin greater than that authorized by the Monetary Fund, the weight of fine gold corresponding to the parity of the currency shall be calculated on the basis of the rate of exchange applied in the member State, for current payments, on the date of the calculation, to a currency directly or indirectly defined and convertible into gold, and on the basis of the parity of that convertible currency as declared to the Monetary Fund.

Article 3

The unit of account, as defined in Article 1 above, shall remain unchanged throughout the whole effective duration of the Convention. However, if before the date of expiry of the Convention there should ensue a uniformly proportionate alteration in the parity of all currencies in relation to gold, by a decision of the International Monetary Fund, under Article 4, section 7 of its Statute, then the weight of fine gold defining the unit of account shall

vary in inverse ratio to such alteration.

If one or more member States should not implement the decision of the International Monetary Fund referred to in the preceding paragraph, the weight of fine gold defining the unit of account shall vary in inverse ratio to the alteration decided upon by the International Monetary Fund. However, the Council of the European Communities shall examine the situation thus created and, on a proposal of the Commission and after obtaining the opinion of the Monetary Committee, shall take the necessary measures by qualified majority vote.

11
The collection of texts relating to the management of the earlier Funds has never been translated into English.

Annexe 2

Article 3, § 4, de l'Accord interne

"A compter de leur exigibilité et pendant la durée de ce dépôt, les fonds conservent la valeur correspondant à la parité en vigueur au jour de l'exigibilité par rapport à l'unité de compte définie au Protocole n° 7 annexé à la Convention. "

Article 2, § 5, du Règlement financier

"Au cas où la parité de la monnaie d'un Etat membre par rapport à l'unité de compte se modifie, l'ajustement du compte spécial est effectué dans un délai de deux mois au moyen, soit d'un versement complémentaire de l'Etat intéressé, soit d'un reversement à cet Etat. "

4

Annex 3

GENTLEMEN'S AGREEMENT

The Member States agree that transactions relating to the EDF should be made in units of account in accordance with the following provisions :

1) For the period 10th May to 15th August 1971

The conversion of the German Mark and Dutch Florin into units of account shall be made on the basis of the average official exchange rates of the U.S. dollar as given at the Frankfurt and Amsterdam Stock Exchanges respectively on the day of calculation and based on the dollar parity declared on that date to the IMF.

2) For the period 15th August to 18th December 1971

For those member State currencies whose exchange rates moved outside the fluctuation margins allowed by the IMF the conversion into units of account shall be made on the basis of the parity of the French franc declared on that date to the IMF.

3) For the period following 18th December 1971

Conversion into units of account of the currencies of the Member States shall be calculated :

- for those currencies whose exchange rates did not move outside the fluctuation margins allowed by the IMF, on the basis of the relationship on the day of calculation between the weight of fine gold contained in this unit of account and the weight of fine gold for the central rate of each of these currencies, as declared to the IMF and agreed by that body,

2.

- for each of those currencies whose exchange rates were outside the margins of fluctuation allowed by the IMF, on the basis of the average of the exchange rates on the day of the calculation of all the "snake" currencies vis-à-vis each one of these currencies on the latter's foreign exchange markets.

4) For the period following 1st July 1975

The conversion of the unit of account into the currencies of the member States will follow the procedure resulting from the Decision of the Council of the European Communities of 21st April, 1975.