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Present position as regards convertibility

Report[1]
Committee on Economic Affairs and Development
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1. 1954 - 6th Session - Second part

A. Explanatory Memorandum

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Paras.

1. The Assembly's earlier work on the subject

1. In May, 1953, M. Federspiel, then Vice- Chairman of the Committee on Economic Questions, presented to the Assembly a Report (Document 134, Fifth Session) on " t h e present position as regards convertibility". In this Report he discussed the nature of convertibility and the various types of convertibility that have been advocated, the evolution of the question in international discussion up to that date, the conditions which must be fulfilled before convertibility can be established on a lasting basis, and.the effects which convertibility might have on the economic life of the countries of Europe and on their integration with one another. It is not the purpose of the present Report to repeat what the previous report has already said on the fundamental issues at stake.

2. In that Report, which was adopted by the Assembly in May, 1953, five suggestions were made for early action. I t is interesting to note the developments that have since taken place.

2.1. The Report suggested[2]that the proportion of gold to credit in EPU settlements should be increased, — pershaps, to begin with, to 50 %. As from 1st July, 1954, the E.P.U. raised the proportion to that figure.

2.2. The Report also suggested[3]a simultaneous increase in the size of quotas. The E.P.U. raised national quotas as from 1st July, 1954.

2.3. It suggested[4]that "exchange rates fluctuating within wider margins than hitherto might have some advantages, although these are debatable". This question is still being discussed, and it seems that at the London Conference of Finance Ministers in July it was decided that currencies should be stable — which must mean at least that if there are to be any fluctuations these should not be too large.

2.4. It also suggested[5]that the International Monetary Fund might be willing to give more help to cumulative debtors and to cumulative creditors. The Fund has been giving such help, and it may 'well be that the role it will have to play if convertibility is attempted'will become still more substantial.

2.5. Lastly, the Report suggested[6]the reopening of more private commodity markets by the issue of licences to traders resident in the country concerned to import from whatever is the cheapest source of supply. This re-opening of commodity markets has since gone on apace.

3. In his speech to the Assembly, as in his Report, M. Federspiel called upon tho Assembly to pass a draft Resolution laying down a number of principles, of which three were of particular relevance to the countries of Europe at the moment at which they were put forward. The Assembly adopted the Resolution[7]emphasising:

3.1. that the convertibility of currencies must never be achieved at the price of restrictions on trade ;

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2. Paragraph 40.
3. Paragraph 41.
4. Paragraph 41.
5. Paragraph 41
6. Paragraph 42.
7. Resolution 29 of 13th May, 1953.

3.2. that measures designed to restore convertibility of a European currency should not be taken unilaterally ;

3.3. that the first steps should be taken along lines which will not jeopardise European integration.

2. The Balance of Dollar Payments

4. The Report adopted by the Assembly laid clown two conditions that must be satisfied before any country can safely embark on convertibility. The first of them was an equilibrium in its balance of payments : "taking one year with another all countries participating in the multilateral system must be receiving, inclusive of any special loans and grants, about as much hard currency as they should expect to lose if they make their currencies convertible"[8]. The Rapporteur noted[9]that the balance of payments for tho six months before he was writing had been favourable as a result of American Government grants. He felt, however, that aid, for political no less than economic reasons, was not the most satisfactory way of overcoming the dollar deficit, and that, so long as it is voted by Congress in annual instalments it will do little to re-establish confidence in the permanence of the equilibrium of the European dollar balance of payments.

5. The favourable balance of payments between Europe and the dollar area has continued since that report was drawn up. In 1953 OEEC member countries ran a trade deficit of $ 1.2 billion[10]on current account with the dollar area as a whole (excluding $ 3.5 billion of imports of military end-items). This was offset by $ 1.2 billion for off-shore purchases and local military expenditures and, in addition, $ 1.1/4 billion of aid[11]. The European deficit on goods and services was thus fully offset by payments for military purposes, and other transfer payments from the United States went to balance capital movements and raise the European gold and dollar reserves. If we can expect aid of various kinds to continue to make up the difference between other dollar receipts and total dollar expenditure then the balance of payments of Western Europe and its associated monetary areas may be regarded as being in equilibrium.

6. It should be noted here that this favourable balance of payments on current account with the United States continued during what was definitely an American recession. I n 1948-1949 United States production fell by 8 % — no more than it did in 1953-1954, and in both cases the fall in imports ran parallel to the fall in production. Yet in 1948-1949 the American recession was the last straw that broke the sterling-dollar rate and with it the dollar rate of most other European currencies, while in 1953-1954 European reserves were still gaining some strength during the recession. The difference is worth examining in detail, but for our purposes it is sufficient to say that partly it was due to a fall in American import prices during? the first, but not the second, recession ; more important was the geater value of American aid to Europe today; again, American imports from the rest of the world are now much greater than they were before; and, finally, there was this time no speculative movement against European currencies.

7. This should not, however, lull us into a false sense of security ; wo have no reason to believe that American recessions will not in future continue to present real dangers to the European economy, particularly if European currencies are convertible into dollars. Circumstances may not always be as favourable as they have been this past year ; and we do not know how far the present volume of American aid to Europe and to the rest of the world will be maintained for the future. While M. Pcderspiel's argument[12]might thus be re-stated in greater detail, it is 'by no means reduced in cogency as a result of recent experience.

8. Perhaps the danger of over-confidence today makes it all the more important that the Consultative Assembly should re-affirm its conviction that, if the United States wishes to cooperate in the creation of a multilateral nondiscriminatory system of trade and payments, the raising of American tariffs (as was done recently in the case of the tariff on watch movements) is unhelpful and psychologically unwise. Tlie rejection of tenders for public works made by European firms in spite of their being well below tenders from American firms is equally discouraging. More nearly in accordance with paragraph 7 of Resolution 29 (1953) is Mr. Eisenhower's demand[13]for legislative authority to reduce or end the preference beinggiven to domestic over foreign tenders in the allocation of government orders.

8. Paragraph 16.
9. Paragraph 19.
10. Billion' is used in this document in the economists' sense of a thousand million.
11. Figures supplied by the O. E. E. C.
12. In paragraph 22 of Iris Report.
13. Message to Congress, March, 1954.

3. The Gold and Dollar Reserves

9. The second criterion which M. Federspiel laid down for convertibility was the adequacy of foreign exchange reserves. At the time when he was writing the United Kingdom's reserves stood at $ 2.3 billion ; they have since risen to just over $ 3 billion. Similarly, the gold and dollar reserves of all E PU countries combined have risen from $ 8.6 billion in December, 1952, to $ 11.7 billion today[14]. Europe and the sterling area are thus in a far better position than they were sixteen months ago ; but the question remains — are their foreign exchange reserves today sufficient for convertibility to be attempted ?

10. Needless to say, any figure that might be given of what would constitute an adequate foreign exchange reserve would be a guess. Over the last few months the opinion has been widely voiced that the United Kingdom needs at least $ 5 billion worth of gold and dollar reserves before the sterling area can embark on convertibility. Assuming that this is a reasonable figure under present circumstances and with regard to expectations of future trends it must be asked how the remaining $ 2 billion can be secured to make sterling ready for convertibility.

11. There have been reports that the International Monetary Fund might be willing to grant a stand-by credit of $ 1.3 billion to the sterling area if it adopts convertibility and accepts certain rules on multilateral trade practices. Proportionate credits might also be given to other countries. The United States Administration now favours this type of action by the International Monetary Fund, and decisions on the subject may be arrived at during the present month. If the International Monetary Fund does decide to adopt such a course it will be a definite move towards the fulfilment of the functions for which it was originally intended.

12. In his Message to Congress which we have already quoted[15]. Mr. Eisenhower stated that, in accordance with the suggestion made by the Randall Commission, a study was being made of the possibility of stand-by credits to be granted by the Federal Reserve System to countries embarking on convertibility. If rumours that such credits might be extended up to $ 500 or $ 750 million are correct — and presumably the figure would be kept a closely guarded secret — then Britain may be within sight of the $ 5 billion that have been mentioned. Under such circumstances, and particularly if some aid is also made available to them, Germany and the Benelux countries may well wish to make their currencies convertible at the same time as the sterling area.

4. Employment and Living Standards

13. The Report adopted by the Assembly went on to examine the effects of convertibility on European trade and integration, emphasising the difficulties that would arise if European countries deliberalised their trade with each other. Its warning against such deliberalisation is still to be taken with the greatest seriousness.

14. It may be that another aspect of the problem should, moreover, be stressed with equal force. In any moves towards convertibility we must remember that payments arrangements are not ends in themselves, but must be judged by their effects on all the economies concerned ; and these effects may make themselves felt by their impact not merely on the level of trade but also on the level of employment, production and the standard of living. This aspect of the problem must be set into strong relief as well.

15. Certainly, it is true that, even with tight foreign exchange control preventing conversion, no European country can today isolate itself from all the effects of a depression in the rest of the world. But if it is vulnerable even when it is protected by as strict a foreign exchange control as was operated in 1948-1949, it becomes much more vulnerable still when it abandons the inconvertibility of its currency. By giving up its control over the foreign exehango with which it has credited others, a country dismantles one of its lines of defence against adverse economic conditions in the rest of the world.

16. In consequence the economy of a converting country may be hit both on the import and on the export side. Other countries which have hitherto been buying in the country concerned will, under convertibility, be able to spend what they earn wherever they like : and there is no doubt that some and perhaps an appreciable proportion of their earnings will be spent not in the country from which they have earned the money but in the dollar area. The exports of the converting country will thus suffer from the full blast of American competition, and employment may fall corresponding.

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14. Figures supplied by the O. E. E. C.
15. March, 1954.

17. Peut-être faut-il d'ailleurs souligner avec la même force un autre aspect du problème. En prenant des mesures visant à l'institution de la convertibilité, on ne doit pas perdre do vue que les arrangements en matière de paiements ne constituent pas des fins en soi, mais qu'il convient de les juger d'après leurs incidences qui peuvent affecter non seulement le volume des échanges, mais aussi le niveau de l'emploi, le niveau de la production et le niveau de vie. I l y a lieu de mettre fortement en relief cet aspect du problème. On the import side, too, dangers can arise. As the demand for exports becomes more elastic and their volume is thrown more upon the mercy of any rise in wages or other costs at home —- or any lowering of wages and costs elsewhere — so imports may have to be reduced to confine them within export earnings. The reduction of imports may reduce living standards; and in a crisis imports of raw materials no less than of consumer goods may have to be cut and unemployment result from the fall in imports as well.

18. Thus, convertibility may mean a reduction in exports and a consequent reduction in employment. I t may mean a reduction in export earnings and a consequent reduction in imports and living standards. The countries of Europe should therefore be careful about the conditions in which they are prepared to launch out on making their currencies convertible even for nonresidents on current account. There is no need for the present Report to enter again into the pros and cons of the theoretical argument. Nor is it the task of the Committee on Economic Questions to" declare at what precise point of time the criteria which the Consultative Assembly laid down in May, 1953, are fulfilled. It is the task of the Assembly to lay down the conditions under which it would favour convertibility and those under which it would reject that system. The Assembly must give political guidance ; it can leave the arithmetic of foreign exchange assets and liabilities, of expected earnings and expected future spending on various assumptions, to economic civil servants who look at the problem with the interests of Europe as a whole in mind. And that brings us to one final consideration.

5. Convertibility and the O. E. E. C .

19. A Report on the present state of the economic integration of Western Europe recently examined by the Committee discussed the relation between convertibility and integration on a theoretical level. I t concluded that non-resident convertibility on current account as it is envisaged at the moment would leave a great many elements of economic disintegration in Europe. The most obvious among them would be certain obstacles to the movement of money, goods and manpower between the countries of Europe. Again, convertibility would be by no means sufficient to eliminate distortions within the European economy or to harmonise action by the eoiuitries of Europe for the common attainment of their economic objectives.

20. If the Assembly is to exert its influence in these matters in the future, certain conclusions must now be drawn of a political and organisational kind. The Assembly may wish to emphasise that, whatever may have been mooted to the contrary in public discussion in recent months, the O.E.E.C. will, even under convertibility, have vital functions to perform. Certain of them indeed, in particular those concerned with maintaining trade liberalisation and raising productivity, will become all the more important if some of the countries of Europe adopt convertibility.

21. It is not even certain that the functions which the O.E.E.C. has been performing in the monetary field will become unnecessary with the abolition of the E.P.U. They may change : but they will not suddenly cease to be. I t was decided at the London Conference that a European Fund to grant credits to the weaker European countries will be necessary to ease the strain which convertibility (whether adopted by themselves or by their trade partners) may place on their resources. I t may well be that the convertible funds of the E.P.U. are insufficient for this purpose and that additional hard currency will have to be raised — whether from the International Monetary Fund or from the stronger countries in Europe or elsewhere.

22. There is, moreover, a point of great political importance to be considered. In tho present state of international affairs, with the vital importance which economic factors have in shaping them, it would be very unwise to abandon any European organisation which brings the eoiuitries of Europe together for joint deliberation, for the confrontation of their national programmes, and for the evolution of a European policy voiced by a common organisation vis-à-vis the United States and the rest of the world.

23. Nevertheless this need not mean that the O.E.E.C. with all its organs must be retained in its present form. With the disappearance of the E.P.TJ. the strong case which the Assembly has repeatedly put forward for the integration of the O.E.E.C. and the Council of Europe[16] becomes of the greatest importance. The influence of the O.E.E.C, now that it is no longer responsible for the distribution of Marshall Aid, may be greatly enhanced by such an integration, and the Council of Europe will equally gain in strength. At the

16. See, for example, Doc. 8 of May, 1952.

present juncture in the affairs of Europe, the integration of the two organisations may greatly contribute to the consolidation of the unity so far achieved and may be a useful aid to progress towards an even closer European co-operation in the future.

24. The Committee on Economic Questions therefore proposes the following draft Recommendation :

B. Draft Recommendation

The Assembly,

Taking note of recent developments and international discussions in the field of convertibility,

1. Re-emphasises the principles which it laid down in its Resolution 29 of May, 1953, in particular :

a. that the convertibility of currencies must never be achieved at the price of restrictions on t r a d e;

b. that measures designed to restore convertibility of any European currency should only be adopted after consultation with all the parties concerned ;

c. that the first steps towards the extension of the trade and payments system should be taken along lines which will not jeopardise European integration ;

2. Wishes to lay equal stress on the importance in any approach to convertibility of keeping a watchful eye on the level of employment and the standard of living of the peoples of all the countries concerned ;

3. Recalls its Recommendations 29 of May, 1952, and 46 of June, 1953, on the integration of the Council of Europe and the O.E.E.C, states its belief that when convertibility is achieved it may prove an appropriate moment to carry out this institutional change and expresses its wish that the Assembly should be consulted on this matter at an early date.