On the Creation of a European Reserve Fund (*)

I. The Monetary Union of the Six

The first stages in monetary integration, which is in any event essential to the survival of the Common Market, have already been outlined in a great deal of earlier work by the Commission of the European Communities, and particularly in its 1962 Action Programme and its Memorandum of 12 February to the Council, approved in broad outline by the Monetary Committee on 9 May of that year. The proposals which follow merely repeat, clarify and integrate into a coherent whole suggestions which have already been sufficiently debated to allow Governments to proceed from discussion to decision and action.

1. The latest proposals of the Commission and the opinion of the Monetary Committee relate essentially to three points:

(a) The need for a common definition of the medium term guidelines of national policies and for the introduction of *prior* consultations to ensure the coordination of short term economic policies, particularly in respect of all decisions of a Member State which may have "a market effect on its internal and external equilibrium and/or on the economies of other Member States.

(*) The reports presented by Mr. Carli and Mr. Triffin at the session held in Brussels on 15 and 16 July last, demonstrate the urgent need to create a veritable European monetary area, capable of cooperating effectively with the American monetary area rather than being absorbed by it. The entry of Great Britain into such a European area would considerably enlarge its influence and its means of action by adding to its institutions and its own resources those of the world's leading monetary, financial and commercial centre outside the United States, namely London.

The considerations submitted in these two earlier reports are not repeated here, but they have influenced and conditioned the concrete proposals which are the subject of the present Report presented to the Action Committee for the United States of Europe, Sixteenth Session 15 and 16 December 1969, Bonn.

These consultations would also cover overall budgetary policy and the fiscal measures designed to exercise a direct effect on external trade ".

(b) The institution of an appropriate mechanism for "*short term monetary support*", integrating into a network which is better balanced from the European point of view the bilateral agreements known as "swap" agreements, under which the Central Banks have already for some years past accorded each other reciprocal lines of credit permitting the unconditional financing of deficits which are by their nature reversible. These agreements are today excessively centred on the Federal Reserve System and should be completed by a complementary — but not additive — network between the six Community countries, and perhaps other leading European countries.

On the model of the European Payments Union (1950-1958), these lines of credit should also be *multilateralised*, i.e. each Central Bank should open in favour of all other participating Banks — and should receive from them — *a single global line of credit*, replacing the existing *bilateral* agreements.

(c) The institutional organisation of the "*medium term financial assistance*" specified in article 108 (2) of the Treaty of Rome in favour of a member country facing exceptional difficulties in its external payments. It is important to define in advance standing commitments which would enable Governments to act quickly in case of need.

Unlike short term monetary support, granted unconditionally by the issuing institutes, "the grant of medium term assistance is envisaged only in conjunction with the acceptance by the country which asks for it of certain conditions concerning the policy which it intends to follow" and which the Monetary Committee thinks should be similar to those applied by the International Monetary Fund.

Some members of the Monetary Committee think it opportune to try to find some way of making the financial assets created by such Community financing as liquid as possible, so as to assimilate them as far as practicable with assets with the IMF which are already treated as an integral part of the reserves of each country, on the same footing as its gold and foreign currency reserves and, in future, its Special Drawing Rights.

2. These proposals, which have already been studied and debated at length, should be rapidly approved by the Council. Their operational implementation would be greatly facilitated by the creation of a European Reserve Fund, integrating these various proposals and, in any event, indispensable to the achievement of another goal which is extremely urgent in the short term and essential in the long term, namely the harmonisation and practical implementation of a genuine Community policy for the financing of non-member countries through the Community monetary and banking system.

The spectacular rise in interest rates on the Eurodollar market, as a result of borrowing on that market by American banks, is now alerting opinion, but is only one of the many signs of the blind and total abdication of sovereignty inevitably involved in the refusal to agree to partial and concerted mergers of national sovereignty necessary to the organisation of a genuine European monetary market in the face of the gigantic United States market.

The Central Banks of the Community countries, at the end of last May, held more than $9.1 billion of their monetary reserves (about 35%) in the form of deposits with foreign commercial banks and other private or public financial assets in London and New York. Around the same date, the foreign deposits of the commercial banks of the six countries totalled more than $15.6 billion. Their spectacular and disturbing increase in recent years and recent months ($1.8 billion in five years from 1959 to 1964, $4.3 billion in three years from 1964 to 1967, and about $7.8 billion in the following fifteen months), is certainly very largely explained by loans to the United States, whose short term indebtedness to foreign commercial banks has increased by nearly $10.3 billion in seventeen months, from the end of 1967 to the end of May this year.

Ideally, the six Community countries should determine in common the credits or credit ceilings granted by their Central Banks to non-member countries. In addition, they should decide in common on the orientation to be given to foreign investment operations by their commercial banks, so as to formulate and apply an *effective* policy in this matter, in the general interest and not merely in the interest of the Community itself.

3. Such an ambitious target no doubt lies beyond the immediate possibilities of agreement between the six countries. A more modest solution, and one capable of negotiation, would be the creation of

a *European Reserve Fund*, in which the Central Banks of member countries would hold, in the form of deposits, a determined proportion of their aggregate monetary reserves. These deposits would be fully liquid and convertible for the settlement of any deficit, outside the Community as well as inside. In practice, this would mean that each Central Bank would be free at any time to draw on its account to reconstitute its revolving funds, which it would continue to hold direct in foreign currency so as to be in a position to support the rate of its own currency on the exchange market.

Deposits with the European Fund would thus be, in this respect, at least equivalent to the reserve deposits at present kept with foreign Central or commercial banks (especially in New York and London). They would have the advantage over them of immunity from the political risk of being blocked and the financial risk of devaluation by the debtor countries. All the accounts of member countries would be expressed in the *unit of account* established by the Community. Nevertheless, in so far as — in accordance with the directives of its members — the European Fund kept part of its assets in gold or in currencies other than those of the Community countries, the depositors would still be in a position to make certain gains or losses on foreign exchange, which would be shared among them *pro rata* to their contribution in gold or foreign currency.

Any possible failure by a debtor in meeting its commitments would be covered by a joint and several guarantee by all the members. We may note that the European Payments Union worked to the general satisfaction — both of members and non-members — without ever having to rely upon a clause of this kind, in a much more disturbed period — the legacy of the Second World War and the Korean War — and in spite of the participation of countries financially and economically much weaker than those of the present Community.

4. Minimum gold and foreign currency deposits might be initially fixed at a modest proportion of the global reserves of each participating country until experience had convinced them all of the effectiveness and the advantages of such a system and of its progressive extension. The deposit of a country in substantial surplus should, however, be at least equal to the amount of gold and foreign currency in excess of a "normal" level, which might be defined as a proportion of the aggregate reserves of the six countries equal to that country's proportion of the aggregate exports of the

Six. This would enable the Community itself to decide whether this "abnormal" accumulation of reserves:

(a) should be effected entirely by the transfer of reserves of debtor countries to creditor countries — excluding any accumulation of reserves in the national currency of the debtor itself — so as gradually to limit the capacity of deficit countries to pursue national policies deemed undesirable by the Community as a whole;

(b) or whether it should, on the contrary, be restored to circulation by the grant of special credits to some specific participant or non-participant country whose deficits cannot be corrected by changes of national policy deemed desirable or acceptable by the Community.

This would in no way prevent the surplus countries from reducing their surpluses and accumulation of reserves by appropriate modifications in their national policies. But it would deprive them of the exorbitant privilege of being able to decide at their own will to use their surpluses to finance this or that country — by the accumulation, for example, of dollar or sterling balances — and to convert at a later date from one currency to another, or into gold bullion, disproportionate amounts of foreign currency accumulated over an earlier period which might extend over many years. (This twofold privilege is one of the most evident vices of the so-called "gold-exchange" standard and is the root cause of the exchange crises which have been shaking the world for nearly ten years past).

Finally, an arrangement of this kind would help the operational financing of "mutual assistance" to non-participating countries as well as participating countries and would enable the Community to formulate and apply a common policy for the conditions — policies of harmonisation and recovery — which should accompany such financing.

5. Each country would obviously be free to increase its deposit in the *European Reserve Fund* above the minimum agreed in common, by additional deposits in gold, foreign currencies freely and effectively convertible into gold or even, subject to the agreement of the other participating countries, its own currency.

Special Drawing Rights would be treated for this purpose as equivalent to gold and could be transferred to the European Fund by any member country in order to increase its free deposit. It

should even be contemplated that all Special Drawing Rights of member countries should be uniformly used in this way, as various Latin American countries have announced their intention of doing, to launch their own Regional Reserve Fund.

6. The network of global lines of credit proposed by the Commission by way of " short term monetary support " (see par. 1 b above) could be integrated in the general mechanism of the *European Reserve Fund*. The aggregate credit commitment to other participating countries would be given concrete form by a deposit by each country with the Fund, in its national currency, and the global line of credit made available to each Central Bank would be given concrete form in a corresponding increase in its deposit account.

In accordance with the current swap agreements and with the Commission Memorandum, these credits should conserve the character of " *short term* monetary support ". To this end, each country would be under the obligation of reconstituting periodically — every three months, or, at the latest, every year — its global deposit in the event of it falling below the agreed minimum (see par. 4 above) completed by its line of credit in national currency.

This reconstitution (or repayment) could be effected in three alternative or complementary forms:

(a) payments in gold or in foreign currencies freely and effectively convertible into gold;

(b) Special Drawing Rights or foreign currencies drawn from the International Monetary Fund;

(c) conditional medium term credits granted to the country by the *European Fund* itself and subject to an agreement as to the recovery policies appropriate to its situation. The conditions to which such credits would be subject would, moreover, be operationally linked with the harmonisation of cyclical policies, on which the Commission Memorandum rightly lays stress.

The conditional short term credits mentioned under (c) might take the form of bonds subscribed by the borrower country and enjoying — like the old European Payments Union credits — an exchange guarantee expressed in the unit of account of the Community and the joint and several guarantee of the participating countries. These bonds would be transferable among Central Banks — being transferred from those whose reserves were falling to those

whose reserves were rising — and negotiable by them on the private market in order to wipe out any inflationary excess of liquidity. They would thus serve to launch what are known as " open market " operations, which are necessary to the organisation of a genuine European financial market.

As the Monetary Committee indicates in its opinion to the Commission, this " medium term financial support " should not necessarily be conceived as the consolidation of a short term aid accorded unconditionally by the issuing institutes. Short term aid does not necessarily lead to medium term support and medium term support may very well be accorded to a country which has not had preliminary recourse to " short term aid ".

7. The most delicate question to be solved at this moment in the monetary organisation of the Six is that of exchange rates.

Everyone agrees that the ideal solution — and *essential* in the long, or even in the medium term, to the survival of the Community — is the absolute stability of the Community currencies among themselves, or even their fusion into a common European currency, perfectly feasible if this stability is irrevocably accepted by the member countries. The practical implementation of such a solution, however, calls for a much closer harmonisation of national policies than it has yet been possible for member countries to accept and to commend to national public opinion (Parliaments, trade unions, etc.). In the absence of such harmonisation, the accumulation of divergences between demand policies and the levels of national costs inevitably leads to persistent disequilibria which cannot be corrected, in the long run, except by compensatory readjustments of exchange rates, restoring a competitive equilibrium between the countries in question.

Any delay in the political acceptance of these indispensable readjustments inevitably involves consequences which are disastrous for everybody:

(a) deflationary pressures and unemployment in the countries whose currency is relatively overvalued, and inflationary pressures leading to rising prices in countries whose currency is " undervalued ";

(b) speculative capital payments coming on top of disequilibria in the balance of current payments and speeding up the reserve losses of countries with overvalued currency, until the point is

reached when the exhaustion of their reserves and their inability to obtain a continuous financial flow from the creditor countries compels them to restore the equilibrium of their external payments by deflationist measures — politically and socially intolerable —, by restrictions on imports of goods and services and on exports of capital — inconsistent with the maintenance of the Common Market — and, finally, by currency devaluation.

These considerations explain why the official circles most attached to exchange stability seemed ready not long ago to accept as a *lesser evil* a more flexible exchange system; the widening of the margin between the buying rate and the selling rate of the Central Bank, the "crawling peg" and so forth. The fact nevertheless remains that this is a solution of despair, confirming and accepting the failure of the harmonisation policies which everyone proclaims as preferable but which the governing circles recognise that they are incapable of implementing.

Unfortunately, this solution is not enough to solve two essential aspects of the problem:

(a) Exchange readjustments can only compensate for variations in the level of *prices and costs* resulting from *prior* failures to harmonise policy, but they cannot redress the disequilibrium due to the excess — or insufficiency — of demand for goods and services compared with the production capacity of the country in question. If these disequilibria persist, changes in parity can merely temporarily correct their external incidences — on the balance of payments — at the cost of aggravating their internal incidences on the trend of national prices. So far, for example, as devaluation succeeds in increasing exports and diminishing imports, it scarcens the merchandise disposable on the national market, speeds up price rises in consequence and in the more or less short term revives the competitive handicap of costs — provisionally eliminated by the currency devaluation — and the external deficit.

(b) The financial pressures of the international payments system are far more imperative on deficit countries than on surplus countries. The reserve losses of the deficit countries will inevitably force them, in the long run, to change their internal policy, to restrict their imports of goods and services and their exports of capital or to devalue their currency . The reserve gains of the surplus countries will not likewise force them to change their policy, to

liberalise their trade in goods and services or their capital movements, or to revalue their currency.

This lack of symmetry is all the more regrettable since it cannot fail to lead to an increasing over-valuation of the national currency which is today used for international settlements, namely, the dollar. If the vast majority of exchange readjustments take the form of devaluations in relation to the dollar, the American economy will become less and less competitive and the growing deficits of the United States will force upon that economically dominant country the increasing adoption of deflationist and restrictive measures, the effect of which will be transmitted to the whole world economy.

8. A permissive system of floating exchanges would afford no answer to these two problems, which can be solved only by:

(a) more effective pressure on the surplus countries as well as on the deficit countries, compelling them to take more rapidly the necessary steps to harmonise their national policies;

(b) the financing of temporary disequilibria by the transfer of reserves and the grant of credits, so far as necessary to avoid too drastic measures of readjustments, deemed harmful and undesirable by everyone;

(c) in the event of prolonged failure of harmonisation policies, exchange adjustments upwards by the countries accumulating excessive reserves, as well as downwards by the countries with a persistent deficit.

9. The economic necessity, and consequent political acceptability, of the international commitments essential to the success of such a programme are much greater for countries whose mutual trade is closely interdependent than for countries which are relatively independent of each other, and particularly for countries whose dimensions ensure both the predominance of the internal economy over external trade and the capacity to tolerate or override the restrictions which other countries may place on their exports. That is why the countries of the European Economic Community were prepared, under the Treaty of Rome, to enter into reciprocal commitments among themselves which most of the other non-European countries would not, at the present stage, be in any way prepared to subscribe and to apply.

It seems more and more probable that the international monetary system will tolerate, in the immediate future, a much greater flexibility of exchange rates than the main currencies of the world have accepted in recent years. The European Economic Community could not, however, commit itself to this line without thereby renouncing its fundamental objectives and risking, sooner or later, its own disintegration. It is perfectly true that it could not prevent the fluctuation of its own exchange rates in relation to the currencies of other countries or currency areas over which it can exert only a modest influence. But it should strictly limit the duration and magnitude of exchange fluctuations between the currencies of member countries, not only in order to perfect the Economic Union — and the political union of tomorrow — at which it aims, but even to avoid the collapse of the progress already made in integrating its financial, industrial, and above all, agricultural, markets.

10. The *European Reserve Fund* would be the indispensable instrument of a common policy, aimed at the maximum stability of exchange rates between the currencies of the Community, until the day — no doubt still distant — when the stability will be sufficiently recognised and assured to be consecrated by the fusion of its national currencies in a Community monetary system.

The present dislocation of the exchange markets, and the social turbulence which is partly its result, obviously make it extremely difficult at this moment to define a realistic range of exchange rates capable of forming a solid basis for the final stabilisation of inter-Community exchange rates. The six countries should nevertheless agree as quickly as possible on the *joint and simultaneous* adoption of an initial network of inter-Community parities of exchange, which they would undertake to defend by:

(a) the intervention of their Central Banks on the exchange market, supported, where necessary, by " short term monetary support " and " medium term financial assistance " from the *European Reserve Fund*, and, in the last resort, recourse to the International Monetary Fund;

(b) the readjustments of national policies which are shown to be necessary by excessive and persistent losses or gains experienced as a consequence of such intervention;

(c) the fluctuations in rates authorised by the European Fund between the selling rate and the buying rate of the Central Banks.

For an initial transitional period, the Fund might authorise, for this purpose, the use of the full margin of fluctuations permitted by the current interpretation of the statutes of the International Monetary Fund, namely 1% upwards and 1% downwards, or a total of 2% in relation to the United States dollar, and, in extreme case, a margin of fluctuation which might be as high as 4% between the strongest and the weakest Community currency.

It should be possible for the European Fund to *compel*, and not merely to authorise, the partial, or even the total, use of this margin, in the event of the insufficiency or failures of harmonisation policies setting off reserve transfers or recourse to the monetary and financial assistance operations of the Fund which its members deem excessive. The Fund should also be entitled to ask countries whose exchange rates consequently remained for a prolonged period at the upper or lower limit of the permitted fluctuations, to propose to the Monetary Fund a corresponding readjustment of their parity.

In short, it would be just as premature and unrealistic at this stage to adopt an exchange system which imposed the irrevocable stability of existing exchange rates, and which took for granted the immediate and total success of harmonisation efforts which are still unsufficient, as it would be absurd to resign oneself to constant exchange rate fluctuations, taking for granted the certain and continued failure of these efforts. The immediate aim of the Community in the matter of exchange rates might be summed up as follows. The participating countries fully recognise that inter-Community exchange rates constitute a problem of *common interest*, profoundly affecting the interests of all, and the very survival of the Community, and therefore call for close consultation and *Community decisions*, both on the rejection and on the acceptance of readjustments deemed necessary by a country, *or by its partners*, within the Community, in the event of persistent and excessive disequilibrium — surplus or deficit — of balances of payments.

There is every reason to hope that the events of recent months will help to make such a principle acceptable, in the place of either a premature and unrealistic regidity of exchange rates or of the floating rate formulas advocated by many people before the revaluation of the Deutschmark and in fact mainly designed to facilitate that operation. The courageous decision of the German leaders has finally, though belatedly, confirmed the inter-Community readjustment proposals which failed at the Bonn Conference in November,

1968. The Community would have spared itself, and the world, nearly a year of disturbances which have profited no one except the speculators, if it had succeeded in getting adopted at that time the *simultaneous* adjustments which were manifestly essential. This year of *procrastination* has merely resulted in compelling a *unilateral* devaluation of the French franc, in aggravating the difficulties of other countries (especially Great Britain) and in accentuating in Germany itself an inflationary " overheating " which helped to make a disordered rise of wages and prices inevitable.

The lesson of these facts is too obvious not to serve as a guide for the future.

11. The determination by the Community of exchange rates within the Community should have a twofold aim:

(a) to accelerate, in the immediate future, the readjustments which may still be made indispensable — and in the longer term, inevitable — by failure to harmonise internal policies;

(b) to intensify efforts to harmonise these policies, until they succeed and become institutionalised, thus making it possible to maintain in fact and to institutionalise in law, the stability of exchange rates between Community countries and ultimately to go on to merge national currencies in a single Community currency.

The restoration of order among inter-Community exchange rates should also do away as quickly as possible with one of the most startling and absurd paradoxes of the present exchange system, namely, the maintenance of margins of intervention between Community currencies authorising fluctuations among themselves twice as big as the fluctuation permitted between any one of them and the currency of a non-member group, the United States dollar. Fluctuations between the currencies of member countries should be brought down without delay to the level of the maximum fluctuations allowed in relation to the dollar, and should subsequently be totally eliminated in parallel with the institutional reinforcement and practical success of the efforts to harmonise national policies to which the six countries are committed by the Treaty of Rome. This means that the stabilisation interventions of the Central Banks on the exchange markets should be made at parity of exchange rates among the currencies of member countries.

12. Intervention by the Central Banks on the exchange market at present makes almost exclusive use of the dollar as currency of intervention. *This roundabout method is in no way necessary to the stabilisation of the European currencies among themselves*, which should be done direct — and more economically — by selling to the strongest European countries and buying in the weakest.

The European Reserve Fund would facilitate these operations by enabling its members to draw on their deposits with the Fund to obtain the currency or currencies to be sold on the market and to credit to their accounts the currency or currencies they had to buy in on the market for the purpose of keeping exchange fluctuations within the limits temporarily permitted and ultimately to do away with them altogether.

The debits and credits with the Fund resulting from these operations would automatically be entitled to the " unit of account " guarantee of the Fund and the repayment clauses specified in paragraphs 3 and 6 above.

13. It would be presumptuous and vain to profess to dictate to governments and their negotiators the exact distribution of competence and voting procedure in the institutional mechanism of the European Reserve Fund they are being asked to set up. We may confine ourselves to suggesting that:

(a) the operations of the Fund could be effected by the *Bank of International Settlements* as Agent for the Fund along the same lines as those which it formerly effected, impeccably and to the general satisfaction, as Agent for the *European Payments Union;*

(b) the current management of these operations — including " short term monetary support " — should be assigned to a *Board of Management* designated jointly by the Council of Ministers, on the proposal of the Commission and reporting every month to the Council of Governors of Central Banks;

(c) a joint meeting of Ministers of Finance and Governors of Central Banks would decide periodically — two or three times a year — the limits within which the Council of Governors and the Board of Management would be competent to make decisions, would set guidelines for the general policy of the Fund in the light of experience gained, and would also intervene in all decisions which might have to be made on " medium term financial support ";

(d) the Chairman of the Commission of the Communities, and the Vice-Chairman in charge of the monetary affairs of the Community would attend the monthly meetings of the Council of Governors of Central Banks and the joint meetings mentioned under (c) above, in order to link the Fund's operations with the coordination of cyclical policies for which the Community is responsible;

(e) the voting rights specified in the Treaty of Rome should be modified, in matters connected with the Fund, in the light of the proportionate contribution of members countries towards financing its operations.

14. The mechanisms so far described are, in any event, essential to the culmination and even the maintenance of the economic unity of the six member countries. In addition, they would make it enormously easier to solve the monetary problems raised by the entry into the Community of other countries, and particularly of one country — Great Britain — whose currency formerly played a privileged role under the gold exchange standard which now lays it open to monetary crises which are the price, inevitable in the long run, which must be paid for the operation of such a system.

II. The Entry of Great Britain Into the Community

15. One of the essential conditions of the entry of Great Britain — or, indeed, any other country — into the Community must be its full participation in the rights and duties of Community members as they result from the negotiations to be opened on the proposals summarised in the first part of this report.

Great Britain should be invited to associate itself with these negotiations as soon as the general principles on which they will be opened have received the agreement of the governments of the present Community.

16. The report discussed by the Action Committee on 15th and 16th July last indicates how the two essentially distinct problems underlying Great Britain's persistent balance-of-payments difficulties should be tackled and solved.

The first relates to the restoration of the balance on current account (exports and imports of goods and services) and in no way

differs from the difficulties which every member country of the Community will encounter occasionally in the future, as they have done in the past, and which will have to be solved, together, by the mutual assistance stipulated in the Treaty of Rome and organised by the *European Reserve Fund*, but, above all, by the indispensable progress in the institutional harmonisation of national demand and costs policies. It is, however, obvious that the magnitude of Great Britain's deficits, and the readjustments required by its entry into the Community, will call for a transitional period, phasing, over a longer or shorter time, the full application of the Treaty provisions, especially with regard to the definitive and irrevocable fixing of exchange rates between sterling and the currencies of the six present members of the Community. The adjustments which may prove necessary in this respect will flow almost automatically from the extent to which the residual deficits to be financed are consistent or not with the volume of mutual assistance and external support which the surplus countries are prepared to accord to Great Britain in the light of its own recovery efforts.

It should, however, be noted that Great Britain's entry into the Community should set off a dramatic reversal of private capital flows, considerably easing the transitional problems touched on above.

17. The second problem, which is special to Great Britain, is precisely the volatility and magnitude of the capital movements resulting from the excessive short term indebtedness bequeathed to the country by the previous role of the pound as one of the two international reserve currencies under what was called the gold exchange standard.

The interventions of the *International Monetary Fund*, and the various Basle agreements made both with the Sterling Area countries and with twelve other big countries, have already ensured the consolidation or medium term refinancing of this indebtedness. These agreements cover almost the whole of the $9.4 billion sterling balances held at the end of June, 1969, by foreign Central Banks, and made up as follows:

(a) about $4.6 billion — including about $0.6 in foreign currency deposits — held by the United States, Canada and continental Europe and almost entirely covered by the Basle agreements;

(b) about $4.6 billion held by the Sterling Area countries and covered by the agreements announced last September;

(c) a fairly insignificant sum of $0.2 billion held by other countries.

The net indebtedness of Great Britain to the International Monetary Fund, in addition, amounted to about $2.3 billion at the end of last June (and August).

18. The problems raised by the Sterling balances may therefore be regarded as solved *in the medium term*, but the maturities and repayments specified in these agreements are likely to create totally unnecessary and dangerous difficulties in future, both for the international monetary system and for Great Britain itself. At a moment when there is still anxiety about a prospective future insufficiency of international liquidities, it is absurd to make the situation even worse by professing to clear off — and therefore to destroy — over a period of four or five years, such a substantial portion of the liquidities created in the course of half a century's operation of the gold exchange standard.

The International Monetary Fund, reinforced by the introduction of the system of Special Drawing Rights, and by an agreement — still to be negotiated — on the creation of an International Conversion Account, should assume a major role in transforming the sterling — and dollar — reserves of the gold exchange standard into genuinely international reserves immune from the instability and the financial and political risks which finally made the functioning of the old system unacceptable.

The O.E.C.D. Economic Policy Committee and working Party No. 3 should, moreover, facilitate the cooperation of the world's leading industrialised countries — and particularly the United States, Canada, Japan and European countries which do not enter into the future Community — in the responsibilities which are incumbent upon them in this respect.

Finally, the creation of the *European Reserve Fund* would equip the European Community with a suitable instrument for the most effective organisation of its participation in this indispensable reordering of the international monetary system, and would assure it of the political role appropriate to the contributions which it has unceasingly made towards solving this problem.

19. The European Community, enlarged, in the near future, by the accession of Great Britain and other countries, is destined to

become one of the world's two leading financial centers. The surpluses on current account (after deducting unilateral transfers abroad) of the present Community of the Six approached $4.4 billion in 1967, and — in spite of a deficit on the part of France as abnormal as it was considerable — $4.2 billion in 1968. These figures have only once been exceeded by the United States in the last twenty-five years ($5.9 billion in 1964), the American surpluses falling to $2.2 billion in 1967 and giving place to a deficit — certainly also abnormal — of $0.3 billion in 1968.

The *European Reserve Fund* would provide the Community with the indispensable instrument for the direction of such a market and for an intelligent and concerted utilisation of external resources, excessively absorbed in recent years by financing the deficits and capital exports of Great Britain and the United States (see the Triffin Report presented at the session of 15th and 16th July last at Brussels).

The entry of Great Britain into the Community would, moreover, enable the Community to revivify and to use for this purpose the vast network of world-wide financial relations developed over the centuries by the City of London, but which British savings have been unable, for many years past, to sustain.

20. A first step in this direction could be the definitive consolidation, by the European Fund itself, of the sterling reserves still precariously held by Central Banks other than those of Europe and the United States in excess of their revolving funds. The total amounts held by these countries were estimated at about $4.8 billion at 31st June last, of which the $4.6 billion held by the Sterling Area countries have already been the subject of the medium term consolidation agreements announced at Basle in September, 1968. In view of the very close relations traditionally maintained between these countries and the City of London, the revolving funds which they would wish to keep in sterling may be roughly estimated at about $2.5 billion (10% of their imports of merchandise and net invisible payments). This would leave about $2 billion exposed to withdrawals, which is, moreover, the figure which twelve large industrial countries have also agreed, by the Basle agreements, to refinance in this event. The Community countries have certainly already taken a very large share in these commitments.

In order to stave off the threats of speculation which still hang over the pound, an earlier and less precarious consolidation of these commitments would be highly desirable. The Overseas Sterl-

ing Area countries would be invited to deposit with the *European Reserve Fund* the sterling balances which they deemed surplus, or about \$2 billion. They would receive in exchange a deposit account, freely usable to finance their deficits (but not to accumulate gold or third currencies) and benefiting from an exchange guarantee by reason of the fact that these assets would be expressed in the Community unit of account.

Great Britain would deliver to the European Fund very long term bonds — or even "Consols" with no fixed maturity — also expressed in units of account for the equivalent amount.

These two sets of transactions would initially be reflected in a simultaneous and equal increase in the assets (\$2 billion) and the liabilities (from \$7 billion to \$9 billion) of the European Fund.

What would happen next?

21. The disequilibrium of payments *among* the Community countries themselves would obviously leave unchanged the total assets — and liabilities — of the European Fund resulting from the payments described in the previous paragraph.

The deposits with the Fund would, moreover, fall if the sterling depositors drew on their accounts to finance subsequent deficits, or would increase if they deposited with the Fund convertible currencies acquired by them in settlement of their surpluses.

It is practically inevitable that this second possibility should prevail over the first, in the long, or even in the medium term. The monetary reserves of such a vast group of countries as the Sterling Area cannot fail to grow in future, as they have always done in the past, with the growth of their production and of their international trade. During the ten years from 1958 to 1967, for example, the monetary reserves of the overseas Sterling Area countries (including their assets or net claims on the International Monetary Fund) increased by nearly £1.2 billion, rising by £1.5 billion in seven out of the ten years and falling only by £0.3 billion during the remaining three years (1958, 1960 and 1965) (1).

(1) The simultaneous fall in their sterling reserves is all the more striking and reflects the conversion of sterling into other currencies — mainly the dollar — and into gold. Such conversions would be ruled out, both by the agreement suggested above and by the agreements negotiated last year between the United Kingdom and the overseas countries of the Sterling Area.

It is therefore highly probable that the deficits occasionally incurred by the Area will be modest in amount and more than offset by the surpluses of the Area over a period of time. Their momentary incidence on the operations of the European Fund will differ according as the deficits are towards the Community, Great Britain or the rest of the world.

(a) Deficits towards the rest of the world would be settled mainly in dollars. The few hundred million dollars, at most, which the Fund might be required to disburse in this event, would be offset by the decline in its indebtedness towards the Sterling Area countries, while its claim against Great Britain — accompanied by a "unit of account" guarantee — would remain unchanged. In fact, the Community countries would have diversified their assets by substituting claims in units of account for a modest part — *largely unguaranteed* — of their claims in dollars.

(b) Deposit withdrawals by the Sterling Area to finance deficits towards Great Britain would be offset by a simultaneous and equal fall in the indebtedness of Great Britain to the Fund. Such a turn of events could only be welcomed, as Great Britain would be paying off, thanks to its current surpluses, part of the excessive indebtedness incurred by it in the past towards the Sterling Area, and transferred to the Fund.

(c) Finally, any deposit withdrawals to finance deficits of the Sterling Area to the Community itself would be offset by the fall in the assets of the Fund, in national currencies of the Community against its own members. These countries would thus find their "net" reserves growing in consequence of their surpluses against the Sterling Area. Such a result would be welcome to them, unless it coincided with a period of overheating of their economies, and thus increased the inflationary pressures exerted on them. But this danger would be no greater than it is at present, when all sterling withdrawals by countries of the Area are in fact financed by salvage operations, either after the event, in the past, or pursuant to the Basle agreements of last year, and threaten each time to set off speculative movements which will further worsen the British deficits and increase the amount of finance to be accorded by the Central Banks.

22. There can therefore scarcely be any doubt that the arrangement proposed above would serve the interests of all countries

concerned and would help to redress the international monetary system.

(a) It would do away with one of the main sources of Great Britain's balance-of-payments instability and with speculative attacks on the pound.

(b) It would offer new outlets for the savings of the Continent by associating them with the reconstruction of a vast European international finance market which could be harnessed to the service of a common policy.

(c) It would contribute to the improvement of the international monetary system by organising in a concerted and less precarious manner, the use of the Community reserves, formerly excessively absorbed by the hoarding of sterile gold, and nowadays, by direct or indirect — through the Eurodollar market — credits to the richest and most highly capitalised country in the world.

Every policy certainly has its risks, but those which might flow from the reforms proposed above would certainly be less than those boldly faced, with a success which is now unanimously recognised, by the signatory countries of the European Payments Union in a Europe and in a world whose monetary, economic, social and political equilibrium had been profoundly shaken by the sequels of the Second World War and the opening of the Cold War. As to the risks involved by the refusal or inability of Europe to choose a policy, they are clearly highlighted by the events of recent years and recent months; the accelerated rush to a Dollar Area, itself weakened by the monetary, financial, economic and social chaos of a chain reaction of restrictions and devaluations, and towards a monetary system which the former Governor of the Bank of Greece characterised, in a recent book, as the system of " speculatocracy ".

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