Problems of E. P. U. and Italian Commercial Policy

by

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1. — The European Payments Union was conceived as a central institution to which the members would grant, or from which they would obtain multilateral credits sufficient to finance surpluses or deficits in the payments resulting from their transactions with other member countries or their currency areas. The question is whether the amount of the credits available in present conditions is large enough to finance the surpluses and deficits. And is there enough alternation between surpluses and deficits in intra-European payments to allow credits to be repaid after a certain time, so that the system shall work?

E.P.U. was also conceived as a clearing house for settling balances in the payments arising out of intra-European transactions. Hence a further question: is this clearing house function still needed, or is it out of date because other solutions have been found?

2. — The answer to the first question can be seen from the way in which creditor and debtor positions are distributed between member countries (*Table I*). The figures in this table show how the extreme positions were concentrated in a few countries at the end of 1953. Those in Table II show how the extreme positions of the creditor countries have tended to become aggravated at increasing speed.

Practically all the persistent creditor countries have exhausted or nearly exhausted their original quotas, plus the « rallonges » or additions agreed for 1953 and 1954. While the persistent debtor countries are not so near the exhaustion of their quotas, they too are moving towards a complete utilization of their available credit margins. Thus the credit margins in the E.P.U. are in process of disappearing, and there is no likelihood of their being reconstituted through a reversal of positions. The extreme positions which have to be settled outside the quotas are increasing (*Table II*).

3. — During 1953 several E.P.U. countries made agreements by which residents in any one of them can make payments to residents in any of the other either in their own currency, or in that of the creditor, or in that

CREDIT AND DEBIT POSITIONS OF E.P.U. COUNTRIES
(at Dec. 31, 1953)

TABLE I

Creditor Countries	Creditor Countries: Percentage of Credit Quota Utilized	Creditor Countries: Unused Margins (millions of units of acct.) within the quota	Creditor Countries: Unused Margins (millions of units of acct.) outside the quota	Debtor Countries: Percentage of Debit Quota Utilized	Debtor Countries: Unused Margins (millions of units of acct.) within the quota	Debtor Countries: Unused Margins (millions of units of acct.) outside the quota	Debtor Countries
Austria	137.3	—	—	40.1	116.9	—	Denmark
Belgium	121.1	—	5.4	160.0	—	—	France
Germany	164.2	—	—	—	—	—	Greece
Holland	104.3	—	84.8	26.8	11.0	—	Iceland
Portugal	75.8	17.0	55.0	54.9	92.5	—	Italy
Sweden	85.1	38.7	—	53.2	93.6	—	Norway
Switzerland	126.0	—	60.0	318.2	—	—	Turkey
				77.5	238.0	—	United States

of a third country in the group taking part in the arbitrage settlements. In this connection the countries in the group have undertaken to allow fluctuations up to 0.75 per cent on either side of par value for their own currency and those of the others in the group on the respective exchange markets. The object of these fluctuations is to cause arbitrage to take place where it is needed. Where for instance any country is a debtor of a second and a creditor of a third, arbitrage deals will cause its debtor position to be settled in the currency of the country of which it is a creditor.

4. — If this arbitrage system were perfect, then at the end of each month every country taking part would have only one balance to clear. There are of course imperfections which prevent this from happening; but still the amount of the balances presented for settlement at the month-ends has been much reduced by the system (*Table III*).

E.P.U. CREDITOR COUNTRIES: SETTLEMENTS OUTSIDE QUOTAS

TABLE II

Creditor Countries	1952-1953 July	Oct.	Jan.	Apr.	May	June	1953-1954 July	Aug.	Sept.	Oct.	Nov.	Dec.	Special Agreements for 1953-1954
	(millions of units of acct.)												
Austria	—	—	—	—	—	—	—	—	4.1	14.2	18.3	26.1	25.0
Belgium	93.9	89.2	91.1	53.7	53.9	69.4	59.4	50.3	40.8	46.6	55.0	69.6	75.0
Germany	—	—	—	—	24.4	77.3	121.2	133.9	160.7	205.1	248.9	321.2	300.0
Italy	8.6	—	—	—	—	—	—	—	—	—	—	—	—
Netherlands	—	—	—	17.1	25.6	23.0	16.0	20.0	22.6	21.1	16.0	15.2	100.0
Portugal	13.2	1.4	—	—	—	—	—	—	—	—	—	—	55.0
Switzerland	—	—	—	—	—	8.2	15.5	39.8	50.2	58.7	62.6	65.0	125.0
Total	*115.6*	*90.6*	*91.1*	*70.8*	*103.9*	*177.9*	*212.0*	*244.0*	*278.3*	*345.7*	*400.8*	*497.1*	*680.0*

TABLE III

MONTHLY SETTLEMENTS OF E.P.U. COUNTRIES
(millions of units of acct.)

	1951	1952	1953
January	236.1	417.8	189.7
February	273.0	368.6	201.2
March	216.5	285.3	249.7
April	224.7	262.2	227.4
May	269.8	256.3	186.4
June	339.7	304.4	178.7
July	355.4	238.0	175.4
August	350.4	195.9	139.6
September	379.9	233.8	169.5
October	532.3	235.0	165.1
November	395.2	264.3	160.7
December	361.5	270.8	169.2

5. — To sum up so far:

(a) Exhaustion of the quotas and « rallonges » means that no margin is left for credits to be granted to or by E.P.U. As a means of financing surpluses or deficits E.P.U. is tending to fade out; and settlements are likely to have to be effected more and more by drawing on foreign exchange reserves.

(b) The tendency to « concentration » of extreme creditor and debtor positions continues, and is aggravating the situation described in paragraph (a) above.

(c) An increasing amount of bilateral surpluses and deficits is being settled outside E.P.U. The arbitrage system by which they are settled during the month destroys the function of E.P.U. as a clearing house.

6. — In relation to 1949, the base year used for the determination of the quotas, the volume of visible trade between the currency areas associated with the E.P.U. is up by 48.2 per cent, if measured in terms of imports and by 52.1 per cent if measured in terms of exports. In the case of Italy the imports

have risen by 153 per cent and the exports by 31.7 per cent (*Table IV*). But no adjustments have been made in the quotas, apart from exceptional cases. If it is assumed that the size of the surpluses and deficits will be proportionate to the volume of visible trade, the failure to adjust the quotas has greatly reduced the capacity of the latter to finance the surpluses and deficits in intra-European trade. To restore the same proportions as existed when E.P.U. was set up, the quotas would have to be raised all round by 50.1 per cent, and in Italy's case by 88.1 per cent.

But even supposing that the quotas were thus raised, could E.P.U. do its job of financing surpluses and deficits in trade within Europe?

The answer is that it could do so if the surpluses alternated with the deficits. Recent experience however shows that this does not happen: that on the contrary there is a tendency for persistent creditor and debtor positions to arise. Hence to raise the quotas to the extent mentioned above would still not afford enough margin to cover the surpluses and deficits. To finance positions which are always one way the quotas would have to be increased to infinity.

7. — In any case there are objections to making E.P.U. a system for providing unlimited credit:

(a) Such a system would destroy the inducement for countries with a balance of payments deficit to restore equilibrium. Countries following inflationary policies would be encouraged to continue them, with the inevitable effect on their balance of payments.

(b) Forces of inflation would tend to spread. Countries with inflationary pressures, having no incentive to remedy them for the sake of their balance of payments, would tend to export them without limit.

(c) The system would become a closed one. The E.P.U. currency area might be privileged, but it would become more and more divorced from the rest of the world.

8. — The E.P.U. Statutes provide a compromise solution for the problems outlined in paragraph 7. Article 13, paragraph (b) of the Statutes says that any surpluses exceeding a member's quota are to be settled according to *ad hoc* decisions of O.E.E.C., while under Article 13, paragraph (a) any deficits are to be fully covered by gold payments. The object is to induce creditor countries to follow a policy of economic expansion so as to get rid of surpluses which are not certain to be settled, while obliging debtor countries to amend their policies so as to restore balance of payments equilibrium. The inducement for debtor countries to do this might be effective if they were not allowed the benefit of Article 3, paragraph (c) of the Liberalisation Code: this allows countries having a balance of payments deficit with E.P.U. to restore import quotas.

TRADE BETWEEN THE MONETARY AREAS ASSOCIATED WITH E.P.U. — TABLE IV

Country	Imports C. i. f.			Exports F. o. b.			Total « Visible » Trade		
	1949	1952–53 Sept.-Aug.	1952–53 as % of 1949	1949	1952–53 Sept.-Aug.	1952–53 as % of 1949	1949	1952–53 Sept.-Aug.	1952–53 as % of 1949
	millions of $			millions of $			millions of $		
Austria	256.5	352.1	137.3	168.3	369.0	219.3	424.8	721.1	169.8
Belgian Franc Area	1,071.0	1,693.2	158.1	1,297.3	1,644.1	126.7	2,368.3	3,337.3	140.9
Denmark	518.3	801.3	154.6	547.0	692.4	126.6	1,065.3	1,493.7	140.2
French Franc Area	1,392.4	2,335.8	167.8	1,287.2	1,950.1	151.5	2,679.6	4,285.9	159.9
Germany	1,861.5	2,531.3	136.0	1,495.1	2,990.7	200.0	3,356.6	5,522.0	164.5
Greece	186.4	208.1	111.6	76.4	83.3	109.0	262.8	291.4	110.8
Iceland	39.8	29.5	74.1	33.9	22.9	67.6	73.7	52.4	71.1
Lira Area	599.3	1,516.0	253.0	688.6	960.7	131.7	1,287.9	2,422.7	188.1
Florin Area	1,142.3	1,654.7	144.9	1,214.1	1,790.4	147.5	2,356.4	3,445.1	146.2
Norway	527.6	669.2	126.8	271.3	355.2	130.9	798.9	1,024.4	128.2
Escudo Area	230.8	266.9	115.6	121.6	155.5	127.9	352.4	422.4	119.9
Sweden	728.2	1,147.2	157.5	754.7	1,069.4	141.7	1,482.9	2,216.6	149.5
Switzerland	492.3	764.9	155.4	468.7	711.7	151.8	961.0	1,476.6	153.7
Turkey	156.0	392.7	251.7	145.0	238.3	164.3	301.0	631.0	209.6
Sterling Area	2,816.9	3,450.8	122.5	2,779.9	4,286.0	154.2	5,596.8	7,736.8	138.2
Total	*12,019.3*	*17,813.7*	*148.2*	*11,349.1*	*17,265.7*	*152.1*	23,368.4	35,079.4	*150.1*

9. — As will be seen from Table V, the extent of liberalisation among O.E.E.C. member countries on 31st December, 1953 was considerable except for farm products. For these, even countries with balance of payments surpluses continued to maintain high protection, the liberalisation ratios for those products being 62.2 per cent in Switzerland, 60.8 per cent in Belgium and 79.4 per cent in Germany. France was an exception to the rule as to a high degree of liberalisation, having a general ratio of only 18.2 per cent and one of no more than 7.6 per cent for farm products. Relying on Article 3 (c) France had long since imposed import quotas, and kept them on even when its balance of payments was again in general equilibrium, because it still had a deficit with E.P.U. Moreover, although the French quotas were originally imposed for balance of payments reasons, they called forth protectionist forces which even now make it highly unlikely that they will be removed.

10. — Article 3 (c) of the Liberalisation Code allows any E.P.U. member to revoke liberalisation if the deficit on its balance of payments with E.P.U. is growing at a rate that is thought to be dangerous in view of its reserve position. This provision was agreed when it was assumed that the overall balance of payments of E. P. U. member countries, and still more their balance of payments with

DEGREE OF TRADE LIBERALISATION AT DECEMBER 31, 1953
(millions of $) — TABLE V

Countries	Total intra-European trade in 1952	State Trade		Private Liberalized Trade							
				Agricultural products		Non-agricultural raw materials		Finished and semi-finished goods		Total	
		Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Germany	801	55	6.8	212.3	79.4	269.5	97.8	190.8	93.7	672.6	90.1
Austria	384	5	1.3	21	50.9	69	50.7	45	50.4	135	50.6
Belgium–Luxembourg	980	49	5	138	60.8	292.5	100	381	92.7	811.5	87.2
Holland	908	10	11	53.7	85.4	315.6	99.5	462.4	89.2	831.7	92.6
Denmark	445	2	0.4	46.4	80	156.5	96	133.6	60	336.5	76
France	853	187	21.9	—	7.6	—	30.8	—	10.5	—	18.2
Italy	331	14	4.2	86.1	99.8	150.9	100	68.6	99	315.7	99.7
Ireland	348	1	0.3	35	72.2	69.9	94	155.5	69.4	260.4	75.1
Iceland	43	10	23	—	—	—	—	—	—	—	—
Greece	120	26	21.6	—	—	—	—	—	—	—	—
Norway	457	26	5.6	16.7	79	92.6	88.1	214.3	70.4	323.6	75.1
Portugal	207	—	—	7.8	73.5	60.5	98.9	123.4	91.6	194.8	92.8
Switzerland	586	31	5.2	64.7	62.2	204	100	239.5	97.2	507	91.4
Sweden	766	54	7	35.7	72.3	239.6	99.1	375	89.2	650.3	91.4
Turkey	142	7	4.9	—	—	—	—	—	—	—	—
United Kingdom	1,851	310	16.7	288.8	71.6	372.9	80.0	237.9	71.6	900	75.3
Total	9,222	*787*	8.5	*1,006.2*	*61.1*	*2,293.5*	73.9	*2,627*	*71.3*	*5,936.1*	*70.4*

the dollar area, would be in permanent disequilibrium. In other words it was assumed that no country would be able to finance E.P.U. deficits out of surpluses earned from other areas — and especially not from the dollar area. At that time the dollar shortage was assumed to be permanent. The position now looks different. Under the effect of the

TABLE VI

BALANCE OF CURRENT PAYMENTS OF SELECTED COUNTRIES WITH THE DOLLAR AREA
(millions of $)

Countries	1952 1st half	1952 2nd half	1953 1st half	1953 2nd half
Denmark	+30		+ 26	+ 31
France	−75		+ 49	
Germany	−108	+ 81	+150	
Italy	−122	− 88	− 24	
Holland	− 58	+ 13	+ 49	
Sweden	− 12	+ 5	+ 23	+ 30
United Kingdom	−556	−223	− 59	
Franc Area (excluding France)	−87		− 46	
Sterling Area (excluding UK)	− 98	+201	+133	

heavy military spending by the United States in Europe, some E.P.U. member countries now have dollar surpluses (*Table VI*).

The balance of payments figures in Table VI are not strictly comparable because each country calculates them differently, but they do give an indication. They vary in the extent to which they include dollar economic aid and military aid. Inclusion of such aid, of course, increases the apparent dollar surplus; it is, however, an item which cannot be relied upon and is largely subject to non-economic factors.

TABLE VII

U.S.A. FOREIGN DEFENCE EXPENDITURES
(Annual Rates - Milliards of $)

	1951	1952 1st half	1952 2nd half	1953	1954 1st half
E. P. U. countries	0.31	0.52	0.93	1.47	3.18
E. P. U. countries and monetary areas	0.40	0.67	1.03	1.62	3.34
All countries	1.20	1.53	2.09	2.60	4.22

Table VII shows the yearly amounts of foreign military spending by the United States from 1951 onwards.

11. — To sum up once more, E.P.U. member countries with extreme creditor and debtor positions are concentrated at the two ends of the scale. Some of these positions show signs of being permanent. The volume of intra-European trade has grown, while the quotas of E. P. U. members have remained unchanged; and yet, because the extreme positions persist, adjustment of the quotas would not solve the problem of how to restore a revolving fund of credit. It will further be seen that the dollar shortage of past years is no longer present in so grave a form. This, it is true, is due to non-economic factors which may or may not last; but it does make it seem unreasonable to maintain the rule under which countries with E.P.U. deficits have the right to place quota restrictions on imports.

12. — The following are some of the suggestions put forward for remedying the E.P.U. crisis:

(a) To recast E.P.U., the members undertaking to liquidate persistent debtor positions by paying over convertible currency.

(b) To liquidate E.P.U. and replace it by a system of partial convertibility, confined to settlement of current items due to persons resident abroad.

(c) To replace E.P.U. by a system of full convertibility, giving both residents and non-residents the right to convert each national currency into gold or currencies that are equivalent to gold.

13. — The advocates of full convertibility say that it is the only method which will provide a sure basis for a free market economy: Röpke calls it the « surest anchor » for such an economy. This would permit the removal of exchange control, which they call the « nationalisation of bankruptcy ». It would release creditor countries from their servitude to E.P.U., so that they would no longer be forced to grant it further credits

in addition to those outstanding. It would end the see-saw between increasing and decreasing liberalisation. It would operate on the basis of fixed pars of exchange; and with the support of stabilisation funds, it would exclude all controls over foreign payments, including transfers of capital. It would imply the re-establishment of an international capital market. The system would oblige countries which applied it to adopt orthodox financial and credit policies.

Under partial convertibility on the other hand there would be exchange control in order to discriminate between current payments and capital movements. Only balances arising from current payments would be convertible, not those originating from movements of capital. Moreover, convertibility would apply only to balances which had accrued to foreign residents from recent transactions. Under this system it is not supposed that general measures of financial or credit policy could be used to restore equilibrium in the balance of payments whenever required. Its advocates indeed assume that situations can arise where such measures would not work, or would not do so soon enough. Their way of restoring the balance is to alter the exchange rate. They do not exclude quota restrictions, but assume that these would be applied without discrimination.

The essential difference between the advocates of partial and of full convertibility is thus that the former accept, while the latter reject, maintenance of exchange control. The former say that exchange control must be maintained in order to prevent capital movements which could upset the balance of payments; the latter think that movements of capital are essential to the working of their system. The former are prepared to alter exchange rates to restore the balance; the latter demand fixed exchange rates, relying on general measures to put the balance right. Essentially the former group admit, while the latter group firmly deny, that the economic policy of Governments may be conducted on lines of « dirigisme ». Thus full convertibility entails complete acceptance of the free market economy, while under partial convertibility the economy may be managed in varying degree.

14. — Under partial convertibility any balances accruing to foreign residents from current transactions may be converted into gold. This right may be exercised at any time. The foreign resident may opt to use the convertible currency to buy goods in the country issuing it, or to spend it anywhere else including the dollar area. Hence, for such a system to last, prices in the « convertible » country must be in equilibrium with those in other countries, including the dollar area. If they are not, everybody will tend to spend the convertible currency where prices are lowest. This is what happened in mid-1947, when prices in the sterling area were higher than in the dollar area, so that holders of sterling spent it in the latter.

If everybody spent the convertible currency where prices were low, this might use up the gold and foreign exchange reserves of the country which had proclaimed convertibility, forcing it to reverse that step. It follows that one condition for convertibility to work is that there shall be no price disparities which have led to the introduction of special measures of protection against low-price areas. That is why the partial convertibility system rules out discrimination against any currency area. Advocates of that system do however admit that the supply of the convertible currency may be regulated by adjusting exchange rates, by applying import quotas, or by both methods; but they require any such measure to be applied without discrimination.

15. — What then are the differences between partial convertibility and the system now in force? The existence of extreme creditor and debtor positions within the E.P.U. now means that, at least on the part of the debtors, balances must be settled in gold. In this respect the E.P.U. system has come close to that of partial convertibility, the difference being that the creditors still accept *part* pay-

ments in golds in settlement of their claims. Moreover, the extreme position reached by some E.P.U. debtors means, or ought to mean, that they need not discriminate against dollar area goods. Much the same applies to the creditors, who are piling up reserves of gold and convertible currency. The E.P.U. system is in fact being transformed by forces which are impelling it towards non-discrimination.

16. — As already mentioned, the partial convertibility system resembles the one now in use in the principle that it excludes readjustments of general policy as a means of restoring balance of payments equilibrium. It does require that the supply of a country's currency should in certain circumstances be reduced by varying exchange rates, by applying import quotas, or by both these methods. As such measures reduce the volume of trade, it is necessary both under partial convertibility and under the present system, to be able to fall back on a revolving credit fund of convertible currency, so as to remedy balance of payments disequilibria. To that extent the partial convertibility system amounts to extending the present one by bringing the dollar area into E.P.U. and giving it a quota.

17. — If all E.P.U. members accepted partial convertibility, E.P.U. might as well be liquidated. There would be no balances for it to settle, because any country having a surplus of another's currency could convert it into gold or its equivalent. But what happens if some E.P.U. members accept partial convertibility while others do not? It would seem that E.P.U. would still have to be liquidated. Every country would put in for E.P.U. settlement its balances in inconvertible but not in convertible currencies. Thus there would again be extreme positions, with the convertible currency countries as creditors and the inconvertible currency countries as debtors.

There is a further problem: how would countries with inconvertible currencies settle with those with partially convertible currencies? The countries with inconvertible currencies could still impose discriminatory import quotas, and would probably discriminate against imports from countries with convertible currencies. If there were many countries with inconvertible currencies, those with partially convertible currencies might seek to escape the effects of discrimination by making bilateral agreements with the countries with inconvertible currencies, possibly providing « swing » credits through such agreements. This would be bilateralism over again, with bilaterally negotiated « swing » credits, and the world market split into water-tight compartments.

18. — One method that has been considered (see paragraph 12) for restoring an efficient payments system is to require persistent E.P.U. debtors to pay off their debts with gold or convertible currency, while giving persistent creditors the right to claim payment in the same way. The object is twofold: to maintain in being a revolving credit fund to finance temporary balance of payments disequilibria, and not to force the creditors to grant unlimited credit. The revolving fund of credit would be provided through the debtors' paying off debt, and so regaining the use of their ordinary credit margins. They would have to pay gold or convertible currency sufficient for the Union to use in repaying credit obtained from the creditor countries.

19. — These considerations lead to the following conclusions:

E. P. U. has largely exhausted the revolving fund of credit which it put at the disposal of member countries to finance surpluses and deficits in intra-European trade. Surpluses and deficits of growing amount are having to be settled outside the quotas with gold and convertible currency.

In this respect the E. P. U. system has come close to what we have called partial convertibility. Under both systems there is less need to descriminate, especially against the dollar area.

A possible compromise solution would be to establish the principle that persistent E. P. U. debtor and creditor balances must be repaid in gold or convertible currency. The E. P. U. system would then still differ from partial convertibility in maintaining a revolving credit fund.

Two main points must be borne in mind when these considerations are applied to the Italian case:

(a) Whether the solution adopted is to continue the E.P.U. but with a plan for liquidating persistent creditor and debtor positions, and whether it is to introduce partial or total convertibility, we shall probably see less discrimination against goods coming from areas where the power to compete is greater.

(b) For some time Italy will probably continue to be an E. P. U. debtor, having to settle by full payment in gold or its equivalent. To that extent Italy can regard the E. P. U. area and areas with convertible currencies as one.

From this it follows that:

(a) In formulating her commercial policy Italy need not discriminate between the E. P. U. area and areas with convertible currencies. The object should be to maintain overall balance of payments equilibrium with all these areas taken together.

(b) The growing competition in these areas confirms that measures to assist exports are needed.

(c) It also confirms the need to increase trade with areas not covered by paragraph (a). Our foreign trade must in fact be freed from the restraints which hamper it in regard to such countries. A condition for the continuation of the liberalisation of imports is the « liberalisation of exports ».