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The European Monetary Agreement — 9 pages

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The European Monetary Agreement

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The European Monetary Agreement, signed in Paris on August 5, 1955, provides for the establishment of a European Fund and of a Multilateral Settlements System. The purpose of the Agreement is "to enable all members . . . , in connection with the return by some of them to convertibility involving a freer system of trade and payments, to maintain a high and stable level of trade and liberalization between themselves, as well as of employment in their . . . countries."

The Agreement will enter into force if and when the European Payments Union is terminated, provided that members accounting for 50 per cent of the proposed contributions to the Fund agree to the establishment at that time. However, if the EPU has not been terminated by March 31, 1956, the Organization for European Economic Cooperation will make a comprehensive review both of the conditions of a further renewal of the EPU and of the provisions of the European Monetary Agreement. In order to bring the Agreement into force without further negotiation, the EPU will therefore have to be terminated (and the convertibility of the leading European currencies established) not later than on March 31, 1956.

If the Agreements enters into force within that period, all members of the OEEC--including those that do not express their agreement at the critical date--will automatically participate in both the Fund and the System. At the end of the first year, members will have an opportunity to withdraw from the System though not from the Fund; the Fund will operate for a period of at least three years.

Both the Fund and the System will be operated "under the authority" of the OEEC Council by a Board of Management of not more than seven members; a U. S. representative and the chairman of the Intra-European Payments Committee of the OEEC may attend the meetings and participate in the discussion. The BIS will continue to act as Agent for the Organization. The decisions of the Council require unanimity of all voting members (members accused of a violation, however, will have no vote in that matter); but the decisions of the Board will only require four affirmative votes, and the day-to-day operations of the Fund and the System will therefore not be hampered by the unanimity rule.

The European Fund

The Fund will grant its members non-automatic credits repayable within not more than two years, "in order to aid them to withstand temporary overall balance of payments difficulties" that would "endanger the maintenance of their intra-European trade."

The principle of non-automaticity of Fund credit is breached only insofar as, before the establishment of the Fund, the Organization may decide that in special cases credit facilities will be available to individual countries from the start of the Fund's operations. These credits will have to be drawn in the first year, and will be repayable not later than at the end of the second year of the Fund's operations; their total amount shall not exceed 25 per cent of the Fund's resources. However, some automatic credits are stipulated in connection with the Multilateral System since the members will have the right to request their fellow members--though not the Fund--to furnish "interim finance" up to specified amounts and for strictly limited periods.

In considering a credit application to the Fund, the Organization "will have regard not only to the situation of the country concerned but also to the necessity of using the assets of the Fund in the best interests of the Organization as a whole"; in particular, it "will take account of the way in which the country concerned is complying with any recommendations that may have been made to it with regard to the various aspects, internal and external, of its financial and economic policies, and of the degree to which its trade is subject to controls or restrictions." In line with the principles of the EPU, domestic policies thus are expressly made a concern of the Organization.

The Organization may subject the granting of credit to conditions, "having due regard to the obligations undertaken by that country" both within the OEEC and in other international organizations; in other words, the conditions must not conflict with the country's obligations, say, under the Bretton Woods Agreement or the GATT. The Organization also may make recommendations to other members to take measures alleviating the difficulties of the borrowing country.

The Fund will have a capital of $600 million, including $271.6 million to be transferred from the EPU and $328.4 million to be subscribed by the members. The capital transferred from the EPU will consist of $113 million in gold, about $123.6 million representing the unpaid original subscription of the U. S. Treasury, and $35 million representing loans made to Norway and Turkey. The contributions of the members will be apportioned approximately according to the size of their EPU quotas, and range from $86.6 million for the United Kingdom to $1 million for Iceland. However, the payment of the contributions of Austria, Denmark, Greece, Iceland, Italy, Norway, and Turkey, totalling about $57 million, will be deferred for the time being. In view of this deferment and of the illiquidity of the claims against Norway and Turkey, the initial working capital of the Fund actually will amount to about $508 million. Even this working capital will be called up only according to need.

In addition to granting credits, the Fund also will facilitate the working of the Multulateral System, and in particular give a limited guaranty for the settlement payments.

All transactions of the Fund will be carried out in gold; the accounts will be kept in "units of account" defined in terms of gold at 35 units per fine ounce. The Council has the power to modify the gold content of the unit, obviously in order to keep it at par with the U. S. dollar in case the gold content of the dollar be changed: this power is necessary because settlement through the Multilateral System will be based on the U. S. dollar.

Credits granted by the Fund will bear interest; similarly, interest will be paid on the members' capital contributions and will accrue at the same rate to the residual capital transferred from the EPU.

The Multilateral System

The System is designed to "facilitate the settlement of transactions in the currencies of and between the monetary areas of the Member countries," primarily by providing for "very short-term credits" (called "interim finance") and for the monthly settlement (not called clearing) of balances.

The System will impose three obligations on each member: (i) "to declare margins--valid until further notice--beyond which it will not allow the value of its currency, in terms of a given standard, to fluctuate; this obligation shall not apply in the special case of a country whose currency is not quoted on the market of any other Member country"; (ii) to grant "interim finance" to other members; (iii) "to settle in U. S. dollars its net debt in the monthly settlement, if any, vis-a-vis all other participating countries, and to accept U. S. dollars in settlement of its claims in the same circumstances"; consequently, each country must establish buying and selling rates for its currency in terms of U. S. dollars even if its currency (e.g., under Art. IV, Sec. 1, of the IMF Agreement) is basically linked to gold or to a currency other than the dollar.

The margins fixed under point (i) will be the price at which the country "will be prepared, until further notice, to buy or sell its currency"; they may be fixed in terms of gold, of the U. S. dollar, or of other convertible currencies. The margins will be notified "to all other central banks of the participating countries, and to the Agent." Each country shall be free to determine the margins "on its own sole initiative," and where necessary, after consultation with the IMF; but the margins so determined will remain binding until notice of a decision to modify them has been given to all other central banks and to the Agent. It is "the intention of all participating countries that the margins adopted by them will be as moderate and as stable as possible"; however, there is no firm commitment in this respect, and no numerical limit is mentioned.

If a country fixes the margins in terms of another member currency, these margins must not be "less than the margins fixed by that other country in relation to gold or the U. S. dollar." By fixing margins in terms of another (or all other) convertible member currencies, a member can make sure that the maximum deviation from par between its currency and that of the other member (or members) would not exceed the difference between the upper and the lower margin, instead of the sum of the differences between the margins of the two currencies involved. For instance, if the margin for sterling in terms of dollars is ± 2 per cent, and the margin of the guilder in terms of dollars ± 1 per cent, the maximum deviation from par between sterling and the guilder would be 3 per cent (i.e., if sterling is at 2 per cent discount but the guilder at 1 per cent premium against the dollar, or vice versa); only by fixing the margins of the guilder in terms of sterling (at ± 2 per cent) could the Netherlands make sure that the maximum deviation from par between sterling and the guilder would be kept within 2 per cent.

The "interim finance" provisions give each member the right "during any month to call on all or any of its partner countries to make their currency available without requiring an immediate settlement in gold or dollars." These advances may take the form of a "swap" of currencies between the central banks involved, or of a simple "overdraft." There is no real difference between these forms since in any case the lending central bank shall "have the right, if it so desires, to call for the deposit, up to the time of settlement, of a similar amount in its partner's currency": in other words, the "overdraft" can, at the request of the lending central bank, always be transformed into a "swap." However, the "borrowing" central bank can at any time before the end of the month choose to repay the "interim finance" debt in the currency of the lending country, instead of waiting to make repayment in dollars at the settlement date.

"Interim finance" is strictly limited as to the amount involved; the borrowing right and lending obligation of each member is restricted to about 10 per cent of its present EPU credit quota, and if every country made full use of its right, the total could never exceed $263 million, while for all practical purposes the amount could not exceed one-half of that sum. It is also strictly limited as to maturity; all interim finance debts must be settled in the settlement for the month in which they were incurred. Interim finance debts will carry a uniform interest charge, envisaged at 1-1/2 per cent per annum. In order to enable the BIS to make sure that the credits remain within the stipulated limits, interim finance requests cannot be granted until the BIS confirms that the credit would not exceed the limits either for the lending or for the borrowing country.

Apart from credits under the interim finance provisions, central banks may enter into bilateral credit arrangements "for the support of their currencies, either inside or at the margins fixed for their currencies"; provided that the currencies involved are either convertible or at least "quoted on the exchange market of the partner country." In contrast to interim finance credits, such credits "would not normally enter into the monthly settlements." However, if the central banks involved desire to bring them into the monthly settlements, they must notify the arrangements to the Organization and to the Agent.

In contrast to such arrangements for the support of currencies, bilateral payments agreements "providing, for the settlement of current payments, credit margins in addition to the amount of Interim Finance available under the System" are to be discouraged. All such agreements "must be notified to the Organization" with all their details and amendments. The Organization "may make recommendations to the Parties to such Agreements concerning the revision of the financial provisions thereof" if it considers that these provisions "may prejudice the satisfactory operation of the System or are contrary to the objectives of the European Monetary Agreement." If the countries do not follow such recommendations, the Organization "may decide that balances of accounts kept under the Bilateral Agreements shall not be taken into account" in the monthly settlements. Apart from this case, all balances of accounts under Bilateral Agreements must be brought into the monthly settlements. This provision apparently is intended to make the Organization, rather than the countries involved, the judge of whether or not the balances would be settled through the System, and thus to make it impossible for the countries involved to use bilateral agreements to thwart the credit limitations of the interim finance provisions.

The monthly settlements are to be made exclusively in dollars. The conversion into dollars will be made by the BIS at rates designed to induce borrowing countries to repay their interim finance debts before the settlement date; if they settle through the System, these credits will be calculated at the selling price "fixed for its currency by the country granting Interim Finance": in other words, they must be repaid at the highest rate, most favorable to the lending country. Apart from the case of interim finance, the conversion rate is designed to induce creditor countries to dispose of balances which they hold in the currencies of other members and which they do not intend to keep beyond the settlement date, by selling them in the market rather than settling them through the System; for, in the monthly settlement, these balances will be calculated at the buying price "fixed by the debtor country for its currency": in other words, they can be repaid at the lowest rate, most favorable to the debtor country. Balances under bilateral payments agreements will be calculated on the basis of the rates agreed between the parties to the bilateral agreement.

While balances under interim finance and (approved) bilateral agreements must be settled through the System, other balances will be so settled only if the creditor central bank brings them into the settlement; the debtor country therefore cannot prevent the creditor central bank from selling the debtor's currency in the market (instead of settling it through the System) or holding it beyond the settlement date.

The provisions dealing with the conversion of local currency balances into dollars have more than accounting significance. Currencies that are neither convertible nor at least quoted on European exchange markets are not subject to the "margin" requirements; these currencies will be converted into dollars at their par value. For these currencies there will be no incentive to use the market rather than the monthly settlements for repaying interim finance credits or accepting repayment of outstanding balances. In consequence, it is to be expected that debts in such inconvertible currencies will regularly be settled through the Multilateral System, i.e., 100 per cent in dollars. In contrast, all other currencies will de facto be settled through the market, i.e., without any dollar expenditure in the case of inter-European transferable, and not necessarily in dollars in the case of fully convertible currencies. In other words, countries with convertible (or at least inter-European transferable) currencies may well face less of a dollar burden through inter-European transactions than countries with fully inconvertible currencies.

This fact will not be as important in the future as it used to be in the past since the restoration of convertibility will eliminate most of the economic difference between the dollar and the leading European currencies. Still, the foreign exchange earnings of most Europeans will continue to consist primarily of other European currencies, and conversion into dollars will entail some costs and exchange risks. Therefore, the greater dollar burden may well be an inducement for countries with inconvertible currencies to make their currencies either convertible or at least marketable on European exchanges. In the second case, convertibility would be achieved indirectly since a currency that is freely exchangeable with some convertible currencies can hardly be prevented from being exchanged with all convertible currencies.

Even apart from this reason, not many member countries would be likely to keep their currencies inconvertible and nonmarketable. At present, only Ireland, Iceland, Portugal, Austria, Greece, and Turkey are outside of the European arbitrage system. The first two countries, however, participate indirectly in it as members of the sterling area. Portugal, Austria, and perhaps Greece have gone so far in liberalizing their international payments that they could adhere to the arbitrage system without difficulty. Only Turkey presumably would need further reforms before being able to join the other members. In view of these facts, the entire elaborate machinery of monthly settlements probably will be little used.

The BIS will compute the net amount to be paid by each debtor and to each creditor on the basis of the aggregate settlement figures; each debtor therefore will make payment only to the BIS, and each creditor country will receive payment from the BIS, just as under the EPU, with the difference that all payments are to be made 100 per cent in dollars. The capital of the Fund will be available to enable the BIS to make the out-payments on the same day as the in-payments are due. If a debtor defaults, the Fund will bear the loss up to a sum of $50 million; in the case of an excess default, the creditors would have to return to the Fund the corresponding amounts and keep a claim against the Fund equal to the Fund's claim against the defaulting debtor. In any case, the defaulting country would automatically be suspended.

If a country changes its margins during the month, the balances outstanding at the date of change will be computed at the old margins, and balances accruing later at the new margins. Elaborate provisions deal with the (admittedly "highly unlikely") case of a change in the gold price of the U. S. dollar or of "any restriction of the present buying and selling policy for gold of the U. S. Treasury in relation to the Member countries."

Termination of Fund and System

The Multilateral System will be reviewed not later than three months before the end of its first year; the Agreement as a whole will be reviewed not later than three months before the end of its third year. Members not participating in these reviews will be considered as having withdrawn. After these initial periods, a country may withdraw from the System at any (annual) renewal date, and from the Agreement as a whole at any time on three months' notice. The Multilateral System, or the Agreement as a whole, will be terminated whenever members representing more than 50 per cent of the contributions withdraw from the System or from the Agreement as a whole, respectively.

Withdrawing members will receive their contribution by being allocated the corresponding proportion of the cash held at the Fund at the time of withdrawal and of the repayments of credits granted during the period of their membership. In the case of termination, the assets of the Fund will be approportioned among the members as well as between the members and the "residual" capital (originally transferred from the EPU) according to the initial contributions.

The liquidation quota attributable to the "residual" capital will be divided among the members according to a specified schedule, unless the U. S. Government in consultation with the OEEC decides "that these amounts should be earmarked for the benefit of the Members of the Organization, either individually or as a group." In any case, this quota, in line with the original intent of Congress in appropriating the sum for the EPU, "must be used to facilitate the maintenance of transferability of European currencies or to promote the liberalization of trade of the Member countries of the Organization with one another or with other countries, to promote industrial and agricultural production and to further the maintenance of internal financial stability."

The Council will have power to suspend a member from the Fund and the Multilateral System "if it fails to fulfil any of its obligations under the Agreement." In that case, the suspended country would immediately have to repay any Fund advances, but would remain liable to calls on its contribution to the capital.

Changes in the Code of Liberalization

In connection with the European Monetary Agreement, and in preparation for convertibility of currencies, the OEEC has made some substantial changes in the Code of Liberalization.

The main problem involved concerns the question of whether or how far a member country should be permitted to retreat from the principle of intra-European liberalization if it feels unable to extend the same degree of liberalization to the rest of the world. In this matter, the points of view of the U. S. representatives and of those of most--though not all--European members showed the sharpest differences. Most Europeans wanted to preserve intra-European liberalization even at the cost of some conflict with the principle of world-wide non-discrimination while the U. S. representatives tended to put the principle of non-discrimination first.

The final compromise will leave much to the actual interpretation of the general rules announced. As a matter of principle, a member country will be permitted to suspend intra-European liberalization "in cases where its balance of payments was developing adversely at a rate and in circumstances which it considered serious in view of the state of its reserves." However, the OEEC, before permitting such suspension, "shall pay regard principally to the incidence of specifically European factors on the balance of payments position of that Member country, unless it is a country whose balance of payments is fundamentally influenced by its relations with non-Member countries" and "shall take into consideration the desirability of maintaining intra-European liberalization and the advantages of reciprocity" (underscoring supplied).

Similarly, if a member country fears that the extension of its intra-European liberalization to the rest of the world "would cause it serious balance of payments difficulties," the OEEC would examine the situation "from the particular point of view of its balance of payments and the probable trend of that balance" and then "take active steps to seek methods of co-operation which, through concerted action by the Member countries, would make it possible for the Member country concerned to avoid being constrained to reduce its European liberalization so as to apply a lower level of liberalization on a non-discriminatory basis to all the contracting parties to international agreements covering a wider geographical field than that of the OEEC." Only if these "active steps" fail, would the member be permitted to reduce its intra-European liberalization by "the minimum extent necessary."

Altogether, the compromise seems to incline more toward European "integration" than toward world-wide liberalization; however, the success of the "active steps" of the OEEC members--probably meaning the exertion of pressure, primarily in the IMF, to permit discrimination--will presumably depend on the vigilance of the U. S. representatives in the international organizations as much as on the determination of the representatives of the OEEC countries.

Conclusion

Detailed speculation as to the probable working of the Agreement would be premature since we do not know whether or under what circumstances the Agreement will actually come into force. However, a few very general remarks may be permissible.

The Fund may well play an important role in helping to overcome the reluctance of some of the weaker European countries to make further progress toward currency convertibility and trade liberalization. This function will be particularly valuable if the policies and transactions of the Fund are coordinated with those of the International Monetary Fund.

The Multilateral Settlements System may well turn out to be an institution of potential last resort rather than an actual clearing mechanism. If the inter-European arbitrage system continues to expand, virtually all inter-European transactions will be cleared through the market rather than through the System. Nevertheless, the System may well prove useful because the European countries may be encouraged to rely more extensively on the market mechanism by the assurance that, in the case of an unforeseen breakdown of that mechanism, there is available another multilateral machinery (with its "interim finance" provisions) for the orderly settlement of balances.

Together with the amended Code of Liberalization, the Agreement could thus serve to promote the cause of European cooperation while at the same time stimulating rather than hampering the movement toward world-wide convertibility and liberalization. In this way, European regionalism could remain a bulwark against national restrictions in the member countries, and in addition become a stepping stone toward the more complete economic integration of the free world.