

June 22, 1950

The Agreement on the European Payments Union -  
Statement by Federal Reserve Representative

In December 1949, the ECA submitted to the OEEC a new plan for intra-European currency transferability providing essentially for multi-lateral clearing of intra-European balances through a European Clearing Union (later renamed European Payments Union) and for settlement of net balances remaining after clearing partly in gold and partly in credit. During the NAC discussions of the ECA proposal, agreement was reached that the proposed payments arrangements should not be such as to prevent any one country or any group of countries from moving toward convertibility or toward integration at a faster pace than the rest of the countries.

In the minds of ECA and NAC the principal objectives of the European Payments Union were:

- (1) To do away, as far as possible, with bilateral payments arrangements in Europe and therefore to make an important contribution, on the payments side, to the formation of a single market in Europe, and to the consequent strengthening of the European economy;
- (2) To take a step in the direction of "integration" in which it would be possible for the United Kingdom to join the Continental countries; and
- (3) To provide for a settlement of net intra-European balances that would not be so hard as to prevent the further dismantling of quantitative restrictions on trade, but not so soft as to provide countries with incentives to create or perpetuate excessive imbalance in their intra-European payments relations.

The agreement on the EPU which has now emerged from months of arduous negotiations in Paris and Washington, no doubt represents a considerable achievement with respect to the first two goals. In agreeing to establish a net balance with the Continental countries and to settle it partly in gold in accordance with a predetermined formula, the United Kingdom has traveled a long way from the purely negative stand adopted by it during the session of the OEEC Council in January. In our opinion this agreement would not have been possible without providing for the multilateral use of existing intra-European sterling holdings, and ECA's readiness to indemnify the United Kingdom for actual gold losses resulting from such use was an appropriate price to pay for the agreement.

On the other hand, we view with concern that part of the EPU agreement that relates to the settlement of the net balances emerging from multilateral clearing. It appears to us that a gold-free credit margin amounting to 3 per cent of the total trade turnover of the individual countries, to which must be added a quasi-gold-free credit margin of another 3 per cent, provides most countries with larger credit facilities than are at present available to them and is more than ample

in relation to the actual deficits and surpluses experienced by most countries over the past year. We are not in a position to appraise how much damage this "softness" will actually do in inducing countries to pursue unduly expansionary monetary and fiscal policies; we realize in particular that there are other forces at work in the present situation, in particular the prospect of declining U. S. aid, that might dissuade countries from such policies. But the best we can hope for from the present arrangement is that it will not encourage countries to adopt the wrong monetary and fiscal policies, whereas we had hoped that the scheme would be an active force making for the adoption of the right policies.

While, therefore, we fully recognize the considerable progress achieved in certain respects, we consider that the volume of credit introduced into the scheme represents a potential danger for the internal and external monetary balance of the participating countries and therefore for the ultimate full convertibility of their currencies. The recent special agreement with Belgium somewhat reduces this danger, not only for Belgium, but also for Belgium's debtors, since the latter will now have to use part of their credit margins not for the financing of new deficits, but for the repayment of old debts to Belgium. Nevertheless, considerable progress remains to be made before the scheme could conceivably be regarded as containing adequate incentives for countries to achieve external balance. It is important, therefore, to keep this objective constantly in mind during the final negotiation and implementation of the agreement. In particular all possible efforts should be made:

(a) to introduce more "hardness" into the system through the stipulation of the shortest possible terms for the credits that are to be granted; and

(b) to leave open the possibility of correcting the defects of the present agreement by providing for periodic (say, semi-annual) reconsideration of the gold-credit ratios.