Staff Memorandum No. 220

RD-597

INTERNATIONAL MONETARY FUND

May 4, 1948

To: Members of the Executive Board

From: The Secretary

Subject: Report of Mission to Western Europe

The attached report has been prepared for the use of the Executive Board by the staff members who were sent to Western Europe in February. It has been placed on the agenda for Meeting 313.

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INTERNATIONAL MONETARY FUND

Research Department

Report of Mission to Western Europe

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May 3, 1948

1. Summary of the Work of the Mission

We arrived in Europe in the middle of February and were there for a period of about ten weeks. Except during the initial period of organization, Salle's time was spent entirely in Paris. Triffin divided his time between Paris, Brussels, Basle and Geneva, in accordance with the urgency of the problems presented and the instructions received from the Fund. Time did not permit a visit to London and Amsterdam.

The original instructions of the Mission emphasized three main areas of study:

1. The development of the French economic and financial position under the new French exchange system, and its effects on neighboring countries.

2. The gathering of statistical and economic information in connection with the Marshall Plan.

3. The study of current proposals and discussions concerning the establishment of a multilateral system of intra-European payments.

The first task of the Mission, both in Paris and in Brussels, was to organize a news service and to provide the Research and Operations Departments with other useful sources of information, not normally available in Washington. Full exchange control files were assembled, consolidating all the latest developments in this rapidly changing field. Systematic statistical series on free or black market exchange rates on the principal European markets and other financial information were also obtained. This is being complemented gradually by the collection of unpublished statistical series and other economic information for internal use prepared by the technicians with whom we have been dealing. Closer contacts with the services in charge of preparing such studies and statistics also help in assessing their precise meaning and implications.

Once this primary information was assembled, the next step was to remold it and complement it in such a way as to make it more comparable with information received by the Fund and to illuminate more directly the problems of interest to the Fund. Before leaving Brussels, Triffin completed a detailed study of the National Bank's balance sheet, showing the precise meaning of each item and the evolution of the accounts over the last three years in such a way as to reveal the factors of monetary expansion and contraction which explain the changes in Belgium's money supply during this period. This is still to be complemented and integrated with a similar study of private bank credit on the one hand, and with the changes in Belgium's balance of payments and budgetary situation on the other.

Outside of these routine tasks, the Mission was instructed to attend or follow informally other meetings of interest to the Fund.

1. The third meeting of the Committee on Multilateral Clearing took place in Basle from March 9 to March 15.

2. From there, Triffin visited the Economic Commission for Europe in Geneva and was given access to the original drafts of their Report on Economic Developments in Europe since the war. A digest of this material was prepared well in advance of the date of release of the report.

3. The Sixteen Nations met in Paris during the following weeks to prepare the Charter of the new permanent Organization of European Cooperation. Most of the discussions related to organizational matters rather than to the substantive problems of European economic collaboration and the Fund was not officially invited to the meetings. The Mission obtained the full text of the preliminary drafts together with advance information on the negotiations concerning the apportionment of important posts among the participating countries.

Finally, there was a large number of interviews with technicians and officers of Economic Ministries and Central Banks. Only some of these meetings elicited additional information (for instance, on methods of evasion of exchange control) which could be incorporated in the Missions' reports. Nearly all, however, contributed to a better understanding of the prevailing currents of opinion in official and private circles, concerning economic developments and prospects in the respective countries and in Europe at large. They were also helpful sometimes in clearing up popular and deep-seated misunderstandings and misinterpretation of the Fund's actions and policies, especially with relation to the problems of par values and exchange controls.

2. French Economic and Financial Developments

In view of Triffin's visit to the Basle meeting at the very beginning of the Mission's stay in Europe, the review of the French situation was initiated, and later continued mainly by Salle, while Triffin followed mostly the developments of the Belgian situation and of the Basle discussions concerning the broadening of the present agreements for multilateral clearing operations in Europe. Salle undertook the preparation of three general reports, on exchange, credit and budgetary developments. Special difficulties are encountered in the analysis of the Treasury situation, by reason of the complexity and delays of Treasury data in France itself. It appears, however, that the expenditures of the Treasury--mostly reconstruction of war damages and investment--will be covered during the first half of the year from extraordinary receipts derived from the recent forced loan and from the counter-value in francs of the interim aid. The position of the Treasury is presently very easy, and the Government will not need to have recourse to the Bank of France during the first half of this year. However, new and difficult measures will be necessary to balance Government expenditures during the second half. Of course, the import surplus will be a major factor in offsetting the inflationary effects of the Treasury deficit, but it will not be sufficient to cover all net new investments. The more alarming question remains the price-wage ratio, with its threat to social and economic stability.

The exchange system inaugurated by France last January has grown in complexity because of the difficulties met in negotiating agreements with other countries with respect to the exchange rates to be applied both to commercial and to invisible transactions. The three main agreements concluded so far are those with Belgium, Italy and Switzerland. These are discussed in detail in Salle's report. We shall thus confine ourselves here to a brief summary, followed by a tentative examination of the general trend which emerges from these agreements.

The Belgian agreement covers only French receipts from Belgian tourists, and is directed mainly at channeling into the official market operations which, up to now, went nearly exclusively into the black market. At the suggestion of the Fund, the rate thus established for Belgian franc travelers checks corresponds to the quotation of the dollar on the free market. It is worth noting that barring the exceptional peak on the Paris black market before the suppression of the system of imports "without payment," the premium of the Paris black market over the free market for the dollar is roughly similar to the dollar premium on the Brussels black market. In either case, there is the temptation, therefore, to use dollars in the black market rather than the legal market. It may also be noted that the dollar-French franc-Belgian franc cross rate in Switzerland is about the same as that in the Paris and Brussels black markets.

The exchange rate for commercial operations is unaffected by the agreement and continues to correspond to a cross rate of 214 with respect to the dollar.

In the agreement with Italy, both the commercial and financial rates have been unified at a level which, for the moment, corresponds in practice to the official dollar cross rate between the Italian and the Paris free markets.

Finally, in the Swiss agreement, a system identical to the one previously adopted for the dollar and the escudo has been put into froce with the following exceptions:

(a) There is no communication between the Swiss franc market in Paris on the one hand and the escudo and dollar markets on the other. As a result, the Swiss franc is at a premium (now about 5 per cent) with respect to the official dollar cross rate. This is about the same premium as in the Zurich market.

(b) At the insistence of Swiss exporters, all non-essential French imports from Switzerland were placed at the average rate between the free and the official rates. In order to forestall expected protests from American exporters, and possibly to prevent excessive complication in the rate pattern, the same system was immediately extended to non-essential dollar and escudo imports.

Finally, after a system of imports "without payment" had given rise to a sharp increase in black market rates, the system was discontinued on April 20. The immediate effect was a fall in the black market rate from about 395 to about 355.

It is too early yet to make any prediction as to the further development of the French exchange system. It is likely that the intention of the Government is to return toward the end of the year to a single exchange rate, based on devaluation of the French franc to a rate of at least 260 francs per dollar. From conversations with French technicians, our personal impression is that such a measure is hardly likely to be adopted before a period of at least several months. What is possible in a less distant future would be some modification of the present system which, while remaining short of a flat devaluation, might still decrease the present gap between the French point of view and that of the Fund. Such a compromise might be along the lines suggested in previous memoranda of the Fund, i.e.:

(a) The extension of the free dollar rate for invisible transactions to other selected currencies needed by France, at cross rates based on official parities. (This has been done already in practice with respect to both the escudo and the Belgian franc, and the premium of the Swiss franc over the dollar on the free market is quite small.)

(b) An agreement about an expeditious procedure of consultation with the Fund as to the fluctuations of the free rate beyond a certain range (in practice, the free rate has now been frozen for many weeks within a very narrow margin of about 305 to 306 francs per dollar.)

(c) The extension of the effective average rate for dollar exports to exports in other currencies--whether or not these are admitted to the free market--on the basis of relative par values. This would unify the export rate pattern on the basis of about 260 francs per dollar, but this latter rate would remain subject to uniform fluctuations through changes in the dollar free rate. (The change from 214 to 260 for exports to European countries is likely to be required very shortly for an effective stimulation of French exports, the bulk of which goes to Europe. While French experts still disagree on the need for such a step, a growing body of opinion would favor it for France's own sake and independently of the need to reach agreement with the Fund.)

Such a system would avoid the main objection of the Fund to the French proposals, i.e., the divergent cross rates with respect to exports. The only discrimination involved would be the premium for <u>invisible</u> transactions in "hard" currencies, which the Fund had indicated that it might accept on a temporary basis. On the other hand, the system would preserve the French preference for a so-called free rate for "hard" currencies. The recent evolution of the Franco-British payment accounts would indicate there would be little danger of an excess accumulation of sterling with such a system, even if sterling were also given access to the free rate, a step which the French would still, in all probability, be very reluctant to take at the moment.

Other economic and financial developments in France and Belgium will form the subject of a separate paper by the Mission.

3. Discussions on Multilateralization of Payment Agreements

The third task of the Mission was to follow the progress of current European discussions concerning the multilateralization of payment agreements. The general preoccupation with the need to develop the present network of bilateral payment agreements into a multilateral system of European payments finds its expression everywhere in Europe, from newspaper articles to official committees and meetings. Still, many obstacles stand in the way of any easy, or ready-made, formulas. Instead of being used as working balances, the reciprocal credits granted under payment agreements have gradually become concentrated as credits of a few major surplus countries to the major deficit countries. Many of these balances are now practically frozen, and equivalent to straight loans, theoretically at short or medium term, but difficult to liquidate in practice. This leaves little or no elbow room for the functioning of payment agreements, and since the deficit countries are increasingly unable to make substantial gold or dollar payments to settle balances beyond the agreed credit margins, trade tends to revert toward a rigid barter system, from which payment agreements had originally provided a way of escape.

The September agreement for multilateral compensation has broken down because of its inherent limitations and of the heavy concentration of creditor and debtor balances referred to above. This was, of course, foreseen from the very first, and even the initial promoters of the system defend it only as a way to keep the door open for further talks permitting its enlargement. Indeed, the Basle mechanism has served mostly one important purpose, the achievement of which was considered as nearly impossible in last summer's meetings. It has provided comprehensive and regular information, on a comparable basis, concerning the evolution of payment agreement accounts. This information goes further than mere statistical reporting, since the refusal of proposed compensations is usually accompanied by more or less detailed explanations involving current import plans and programs and forecasts of balance of payments developments.

Discussions are now proceeding at four different levels:

1. The Committee of Delegates (the so-called "Basle Committee) has begun, at the initiative of its president, Mr. Le Norcy, informal exchanges of views which may take a more concrete form in the meetings which are to take place in The Hague, starting on May 15. One of the projects to be examined is already drawn in draft form and was communicated to us informally by Mr. Ee Norcy.

2. The Organization of European Economic Cooperation, recently created in Paris is committed by Article 4 of its statutes to "continue the efforts already initiated to achieve as soon as possible a multilateral system of payments among themselves." Mr. Marjolin, Secretary General of the Organization, indicated to us that he hoped to be able to call a formal meeting of the Committee of Financial Experts around the end of May.

3. The ECA administration is apparently concerned with the problem and has been working on various possibilities involving especially the use of off-shore purchases.

4. The five countries which are party to the Brussels Pact of last March (Benelux, France and the U.K.) are also exploring various projects, with a special interest in the solution of the expected Franco-British payment deficit for 1948. The Brussels meeting of the five Finance Ministers which began on April 28 received some concrete, but divergent, proposals from the British and from the Belgians. While the British, supported by the French, suggested a plan based on the local currency counterpart of American aid, the Belgians proposed the creation of a dollar pool, supplied by a small percentage of Marshall aid.

There is a widespread conviction that the situation cannot be solved without some form of external aid, and some hope, still very vague, that the Bank and especially the Fund will not keep entirely aloof and passive in the face of a problem which is at the very core of the Bretton Woods objectives and philosophy.

The obstacles to a broad multilateralization agreement should not be underestimated. There will be a great reluctance in many quarters to abandon the bargaining advantages, real or fancied, associated with a bilateral system of negotiations both as to trade and payments. The essential condition for the acceptance of a multilaterlaization project is that it should offer sufficient incentives, both to creditor and to debtor nations. From the Fund's point of view, the main prerequisite for intervention would be to ensure the fullest acceptance possible of an automatic system of multilateralization, avoiding the futility and inefficiency of the present Basle system of compensations. This automaticity, on the other hand, should be limited to ensuring the multilateral availability of existing credits, but should not result in any automatic extension of additional credits to countries which do not make sufficient efforts to restore their situation.

On April 1, Triffin forwarded a brief note on the problem. In view of the accelerated pace recently taken by European discussions of the problem, a statement of the Fund's position becomes a matter of extreme urgency, if its views are to be represented before the current negotiations have reached their final stage. The Fund, as well as the Bank, have been invited to participate in the Committee of Delegates, and precise instructions will be needed by our representatives at The Hague meeting on May 16.

4. General Impressions of the European Economy

It is not necessary, and it would clearly be impossible, to undertake here a general, statistical review of current economic developments in Europe. What may not be out of place, however, is a brief summary of firsthand impressions derived from direct contacts and observations.

First of all, as pointed out in previous RD documents, and in Triffin's report from Geneva, the rate of physical recovery is highly satisfactory. Industrial production in Western Europe is now close to, or even in excess of, prewar. The quality of the goods is also improving markedly, and their availability is rapidly increasing. Most striking to the traveler is the difference in Paris from last September to this spring. There is little question that the French devaluation has changed markedly the state of public confidence and expectations. A full discussion of economic conditions in France and Belgium will be presented separately.

There is evident everywhere a great desire to bring about effective economic cooperation and even integration in Europe. Impoverished nations, however, remain very reluctant to risk any sacrifice of their own national interests, and effective progress remains slow. Another important difficulty is of an ideological nature. It is the growing divorce of economic policies between the Northern and the Latin countries. State intervention and controls have been reasonably effective in the first, but failed markedly in the second. Italy and Belgium oriented themselves early toward a relaxation of controls and a return to traditional, and more liberal policies. Their success, and especially the Italian experiment, exerted a powerful attraction on France, where controls had very nearly broken down. Mr. Mayer, the Minister of Finance, embodies the new French policy and has a large following in industrial and financial circles.

The reasons for the Fund's opposition to the French plan are very little understood on the continent, even among informed people. The view is repeatedly expressed that the Fund was opposed to the French devaluation because it marked a breach in the unrealistic pattern of par values which it was attempting to enforce. The Fund's policy is blamed as giving a priority to exchange rigidity at untenable rates, and as stimulating, as a consequence, increasing exchange and import restrictions, in direct opposition to its purposes and objectives.

Similar criticisms are levelled against the British economic policy, not perhaps without some hidden envy at the successful enforcement of controls in England. These criticisms were especially keen immediately after the French devaluation, and few people were willing to concede that an immediate devaluation of the pound would have been detrimental, rather than helpful, to the U.K. position. The attacks seem to have subsided gradually, although they have not yet died down entirely. Emphasis has shifted, however, to the hesitancy of the U.K. to support the more ambitious schemes for economic integration in Europe, a reluctance which is ascribed to a fear to loosen too much British contacts with the Dominions.

5. Practical Conclusions for Fund Action

It is impossible to be in Europe for any length of time without being struck by the prevalence of a highly critical attitude toward the Fund's actions and policies. This is, in part, unavoidable, and reflects the special interests and perspectives of European countries, which do not always coincide with those of an international organization. To a very large extent, however, the criticism springs from misinformation, or lack of information about the Fund's motives and the background of its decisions. Very often, even these decisions themselves are not at all clearly understood.

The Fund has far more to fear from uninformed than from informed criticism. The first could be dispelled by better information, while the second might sometimes be really useful to the Fund as one of the elements which would help guide future decisions and policies. A broader dissemination of the Fund's non-confidential material would be invaluable in this respect. It would also help many members who cannot afford to maintain extensive and competent research services on foreign economic developments.

We might, in addition, offer our members answers, whenever possible, to inquiries about matters which have not yet formed the subject of Fund memoranda, but on which we already possess non-confidential data and studies. In return, we could, in many cases, obtain ourselves communication of internal studies and documents which would help greatly our own Research and Operations Departments and simplify their work. In particular, it would be helpful to extend our informational contacts with the BIS, the Economic Commission for Europe, and, most of all, the Secretariat of the Paris Organization of Economic Cooperation.

Finally, it would be desirable for the Fund to take an active interest in the problem of a multilateral payments agreement in Europe. Whatever the Fund's views may be, their communication to our members and to the organizations or committees charged with the examination of the problem are matters of utmost urgency. The Fund can take a place of leadership in this matter, offering not only financial aid but technical advice which can be most helpful.