The economic and monetary environment at the end of the 1960s

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The economic and monetary environment at the end of the 1960s

At the end of the 1960s, the deterioration in the international monetary climate threatened the Bretton Woods system, particularly as a result of the balance-of-payments policy pursued by the United States. [1] The EEC Member States felt these tensions and had to face the risks that currency speculation posed to their economic stability. The coordination and joint consultations that there had to be among the Six had been undermined by growing differences between prices and costs, which sparked off several foreign-exchange and balance-of-payments crises. There was a risk of these threatening to disrupt the customs union and the common market in agricultural products, which had been operating more or less satisfactorily up to that point.

Turbulence on the money market in Europe increased after the devaluation of the pound sterling. On 18 November 1967, the United Kingdom devaluated its currency by 14.3 %, which delivered a severe jolt to the system. The pound at that time was the world's second reserve currency and was involved in a quarter of monetary transactions in world trade. Sterling's exchange rate value was the outcome of both European and international factors: some researchers therefore took the view 'that it is no exaggeration to see in it [in the tension surrounding the pound] the beginning of the end of the Bretton Woods system'. [2] The weakness of the British currency and the effects of its devaluation on the exchange rate of the pound were used as justification for the veto imposed by General de Gaulle on 11 November 1967 to British membership of the Common Market.

In 1968, the dissolving of the 'gold pool' [3] was followed by serious monetary disturbances. In May 1968, uprisings by dissident French students plunged the country into a difficult political situation, which led to disruptions to the currency. In this connection, Pierre Werner wrote: 'From 14 to 21 November 1968, fierce speculation broke out regarding a revaluation of the Deutschmark and a devaluation of the French franc […] The underlying economic realities called for a widening of the exchange rate disparity between the DM and the French franc […] The German refusal to allow this was motivated primarily by the drop in German farmers' incomes which would occur if the principles of the common agricultural policy were strictly applied on the basis of price unity as expressed in units of account.' [4] The French franc duly came under attack from speculators and on 8 August 1969 the government devalued it by 11.1 %. The German currency then fell victim to speculative dealing and was revalued by 9.3 % on 24 October 1969. As there was a risk that the imbalance between a strong DM and a weak franc would destabilise the common agricultural policy, monetary compensatory amounts were introduced in order to preserve both farm price stability on the French market and German farmers' incomes. These amounts, which were temporary but which lasted for a decade, 'were a distortion of the philosophy behind the common agricultural policy and were later to poison intra-Community relations at the annual fixing of farm prices'. [5] Despite the customs union, which entered into force on 1 July 1968 and was designed to eliminate all forms of quantitative limits on trade between the Member States, in practice Europe carried on being compartmentalised and fragmented, owing to divergent economic policies, differing taxation systems and the monetary compensatory amounts.

But the split went even deeper: consultation between the partners was not working. The decisions to devalue the French franc and let the DM float were taken unilaterally. Community solidarity was seriously weakened by the diametrically opposed interests of France and Germany. There was not just a threat to the functioning of the common agricultural policy, where the need for stable prices dictated urgent adjustments, but above all monetary questions were dependent on very deep-seated national interests and, in reality, fell exclusively within the remit of national sovereignty. Notwithstanding the major progress made by the EEC in the area of the customs union and the common agricultural policy, [6] the advances by the Six in relation to the coordination of macroeconomic policies and monetary cooperation were unsatisfactory and illusory.

At the international level, monetary relations were based on national currencies at fixed, though adjustable, exchange rates and anchored to the dollar in the gold standard. During 1968, the International Monetary System began to run into difficulties and its stability was threatened. On the other side of the Atlantic, persistent pressure on the dollar, for macroeconomic policy reasons, and then exacerbated by the Vietnam War, gradually exhausted the US Treasury's gold reserves. The constant growth of dollar reserves outside the United States ('Eurodollars') made it difficult to convert them to gold at the official rate. [7] In August 1969, to support the Bretton Woods fixed exchange rate system and promote its role in the world economy, the IMF established the Special Drawing Right (SDR), [8] an international reserve asset whose main function was to replace the national reserve currencies, primarily the US dollar. Exchange rates would continue to be stable, though adjustable, and the IMF would monitor the quantity of SDRs so as to meet world requirements for liquidity. This instrument was only able to palliate the short-term weaknesses in the system. Speculation by a fixed exchange rate system on the one hand, and, on the other, the systematic shortcomings of international authorities such as the IMF in relation to the coordination and adjustment of national policies, could only lead to the collapse of the Bretton Woods system.

The monetary turmoil experienced by the Six from the mid-1960s onwards, as well as the difficulties facing the pound sterling — which only highlighted the considerable discrepancies between the countries of Europe — had wide-ranging consequences. At Community level, it had an impact on the coordination of European policies, particularly the common agricultural policy, which was governed by the principle of single prices. To correct the distortions of competition caused by currency fluctuations, compensatory amounts were introduced, but they proved difficult to implement. Since the Treaty of Rome contained only rudimentary provisions in terms of monetary cooperation, close collaboration in this area was not a priority for the Member States; this was reflected by their unilateral approach to devaluation/revaluation measures. The EC countries were part of the International Monetary System, which was characterised by fixed but adjustable exchange rates between currencies that were pegged to the dollar and the gold standard. But the increasing instability of the dollar, the weakening of the Bretton Woods system — which was on the verge of collapse — and the 'fear of seeing the European Community endangered by a disorderly revaluation of the European currencies' prompted the Member States to start working towards economic and monetary union. [9]

[1] This was the 'Triffin paradox' or 'Triffin dilemma', whereby, under the Bretton Woods agreements, the reserve currency (the US dollar) was doomed to depreciate if it had to meet the global economy's demand for international liquidity. Just such a situation helped to gradually erode confidence among foreign business circles in the reference currency: the global economy's crying need for a reliable currency therefore culminated, paradoxically, in a loss of confidence in that currency.
[2] Rücker, Katrin, 'L'adhesion de la Grande-Bretagne à la CEE et la question de la livre sterling', in Dumoulin, Michel (Ed), *Réseaux économiques et construction européenne*, P.I.E-Peter Lang, Brussels, 2004
[3] The 'gold pool', set up in 1961 with the Kennedy plan, brought together the world's main central banks, which decided to coordinate their operations by intervening on the markets to maintain the gold parity at USD 35 an ounce, as required by the gold-standard system. The gold-standard system was set up by the Bretton Woods agreements. The value of the US dollar was pegged directly to gold (at USD 35 per ounce) while other currencies were pegged to the dollar. Central bank reserves then had to consist of currencies convertible into gold and no longer solely of gold. The US Administration guaranteed the value of the dollar but was not required to hold the equivalent in gold of the dollars issued. In May 1968 the 'gold pool' fell victim to excessive speculation and was dissolved. See Eichengreen, Barry, 'Global Imbalances and the Lessons of Bretton Woods', The Cairoli Lectures, MIT, 2007, in *The Anatomy of the Gold Pool*, pp. 35–72. See Bordo, Michael, *The Gold Standard and Related Regimes: Collected Essays*, Cambridge University Press, Cambridge, 1999.
[4] Werner, Pierre, *Itinéraires luxembourgeois et européens. Évolutions et Souvenirs: 1945–1985*, 2 volumes, Éditions Saint-Paul, Luxembourg, 1992, Volume 2, p. 121
[5] Ibid., p. 122
[6] At the end of the 1960s, a certain amount of progress was made in various of the fields in which the Treaty of Rome allowed for common action, particularly in transport, social policy, the common trade policy and tax harmonisation.
[7] The overvaluing of the dollar, which stood officially at USD 35 an ounce, led to a distortion between gold and the standard money for the system. The US authorities' unwillingness to rectify the situation led to the suspension of dollar convertibility on 15 August 1971. The floating of the dollar marked the end of the Bretton Woods system, which theoretically relied on exchange rate stability.
[8] The unit value of the SDR was set at 0.888671 grams of fine gold (or one US dollar). A country participating in the system had to have official reserves — holdings of gold and widely accepted foreign currencies — that could be used to purchase the domestic currency in foreign exchange markets, as required to maintain its exchange rate. But the international supply of two key reserve assets — gold and the U.S. dollar — proved inadequate for supporting the expansion of world trade and financial development that was taking place. The international community therefore decided to create a new international reserve asset under the auspices of the IMF. Only a few years later, the Bretton Woods system collapsed and the major currencies shifted to a floating exchange rate regime. In addition, the growth in international capital markets facilitated borrowing by credit-worthy governments. Both of these developments lessened the need for SDRs. After the collapse of the Bretton Woods system in 1973, the SDR was redefined as a basket of currencies.
[9] Eichengreen, Barry; James, Harold, *International Monetary Cooperation since Bretton Woods*, Oxford University Press, Oxford, 1996, p. 53. See Maes, Ivo, *Economic thought and the making of European Monetary Union*, Edward Elgar Publishing, Cheltenham, 2002.