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UNIT OF REFERENCE TO BE USED IN THE MULTILATERAL TRADE NEGOTIATIONS

Note submitted by the Commission of the European Communities

1. In GATT document MTN/3A/W/3 of 24 April 1974, the delegation of the European Communities indicated the reasons why thought should be given to the choice of the unit of reference to be used in the multilateral trade negotiations. In its view, the need for comparability in time and space as between the statistics furnished by each participant in torms of its own currency unit made it desirable that:

(a) a unit of reference should be chosen;

(b) a method should be determined for converting data in terms of national currency into units of reference particularly from 1973 onwards.

The present paper sets out to analyze the criteria to be met by the unit of reference to be used in the negotiations, and to indicate the methods of calculation and the reasoning which have led the European Communities in making these suggestions.

2. As the statistics furnished by participants in the multilatoral trade negotiations are expressed in terms of their own currencies, they must in any case be converted into comparable figures by applying appropriate conversion rates (clearly defined annual averages).

3. The unit of measurement to be used as a common denominator must observe existing relationships between statistics expressed in national currencies, i.e. it must also respect inter-currency exchange ratios as shown in exchange markets. This will ensure comparability in space.

4. In addition, for comparisons of statistics covering several years, it is important to use a unit of measurement that does not vary with time.

Indeed, if the value of such a unit of measurement differed from one year to another, it would be extremely difficult to distinguish between a variation in the statistics resulting from a change in the unit of measurement and a real variation in the statistics, e.g. resulting from a change in the volume of imports of the country concerned.

This means that the unit of measurement rust allow comparability in time.

MTN/TAR/W/2 Page 2

5. Use of the current dollar would artificially inflate the statistical series to be compared, without any attendant advantage. This would not be the case if the current dollar was itself linked to a fixed point of reference in time.

6. The European Communities therefore suggest that the SDR¹, as fixed from December 1.971 to June 1974, which was equal to the dollar until the monotary readjustment of December 1971, be adopted as unit of reference.

7. For converting data in terms of national currency into this unit of reference, the following night be considered:

- central rates for currencies between which there are still officially limited margins of fluctuation around an average rate which is the central rate communicated to the IMF;
- market rates for other currencies; these rates would be determined by calculating the annual average rate of each currency in relation to all the currencies still directly linked through their central rates to the unit of reference.

The conversion rates would be calculated on the basis of an annual average.

8. As the current dollar since 1971 cannot be considered as an unvarying unit of measurement (like any other currency which may be devalued or revalued), currency novements must be measured in terms of a neutral denominator which is not a currency. This is why, since the first US dollar devaluation in December 1971, changes in the parities or central rates for a currency have been expressed in SDR's². The SDR is a common denominator which is not a currency, but represents the continuation of the former dollar as a reference point unvarying over time for different currencies ($1 \text{ US}_{771} = 1 \text{ SDR}_{771}$).

9. As this unvarying unit of measurement is not a currency quoted on exchange markets, the conversion rate as between each currency and this common unit of reference has to be determined. This could be done by expressing a currency's par value or central rate in terms of this unit of measurement.

¹Special Drawing Right

As an international monetary unit; this function did not disappear on the introduction on 1 July 1974 of a new method of calculating the <u>SDR transaction</u> value between central banks on the basis of a currency basket of sixteen currencies.

However, any announcement of a par value or a central rate for a currency will lose its aim and practical significance unless the currency is simultaneously supported on exchange markets in relation to one or more other currencies also having a conversion rate (parity or central rate) defined in terms of that same common denominator. If the announced central rate or par value of a currency is to be used as the rate for conversion into the unit of reference, it is essential, therefore, that the monetary authorities of the countries concerned be ready to give mutual support to their currencies within officially limited margins of fluctuations around an average rate which exactly reflects the officially intended relation between these currencies by using the same unit of reference, i.e. the former US dollar (1 US\$71 = 1 SDR71).

By virtue of the fact that the rates of these currencies cannot move on the markets beyond a given margin of fluctuation (e.g. \pm 2.25 per cent) from their declared rates, the conversion rate as between each of these currencies and the common unit of reference is on average achieved.

The central rate (or par value), which is simply the conversion rate between a currency and the former US dollar or SDR therefore represents - if supported in this way - a realistic conversion rate for this group of currencies in their exchange market relationship and in relation to the unvarying unit of reference $(1 \text{ US}_{77} = 1 \text{ SDR}_{77})$.

10. Any currency that has abandoned direct linkage with the unit of reference i.e. whose par value or central rate as communicated to the IMF is not supported during a given period - will also have to be evaluated in exchange markets in order to find a realistic conversion rate in relation to the unvarying unit of measurement. This can be done on the basis of an (annual) average market rate in relation with one or more currencies (reference currencies) that are still linked to the former international scrip ($1 \text{ US}_{71} = 1 \text{ SDR}_{71}$).

In the absence of a generally accepted intervention currency.

²See examples in Annexes I and II.

³The US dollar up to March 1973, for example.

⁴As the arithmetic mean of all these currencies or as the median rate between the strongest and weakest currencies in the group (see also example in Annex II). MTN/TAR/W/2 Page 4

11. In a case where annual market rates for a currency in relation with all the reference currencies are not available, one of the following could be taken as the basis;

- those reference currencies which are quoted on the exchange market that is representative of the currency temporarily abandoning support of its reported par value or central rate;
- the average market rate of the currency concerned in relation to the current US dollar, and thereafter the conversion rate calculated and determined as between the unit of reference and the current dollar.

12. With the approach using as a unit of reference a unit of measurement which is neutral (not a currency) and unvarying, the US dollar itself becomes measurable in an objective way like all other currencies.

Statistics in any national currency are simply converted into a common denominator comparable in time according to the evolution of each currency in exchange markets.

As a correction coefficient is used, for example, in converting foreign trade data expressed in national currency into current dollars¹, the suggested approach would simply mean calculating a <u>single annual coefficient</u> for each currency, using the average daily rates of a currency in exchange markets that are generally known and are published in national and international statistics.

13. Use of the former dollar, i.e. the dollar up to December 1971 (1 = 1 SDR), as the unit of reference and use of the suggested method for determining conversion rates as between a given currency and the unit of reference would therefore provide:

- comparability of statistical data in time;
- while affording greater neutrality in respect of
 - . establishment of an average over several years, and
 - . conversion of each currency into a single unit of reference;
- and while respecting inter-currency relationships in exchange markets.

14. So long as most of the currencies are floating freely in exchange markets, no solution in the field of a unit of reference for comparing international trade flows will be perfect. The European Communities are fully aware of this fact, but consider that the suggested solution is the least defective and most objective from the point of view of the aims envisaged for these negotiations.

¹See line "ra" in the IMF International Financial Statistics.

ANNEX I

Unit of Reference (UR) and Evolution of Conversion Rates (Annual Averages)

for Selected Currencies

1. Definition: l UR = 1 $\$_{71}$ = 1 SDR₇₁

2. Conversion rate (annual average): 1 UR equals

•	1970	1971	1972	1973	1974
tiS dollar	1.00000	1.00258	1.08571	1.24781 ^{2/}	1.24442 (sm)
Belgian/Luxembourg franc	50,00000	49°9595	46.6572	48.6572*	48.6572*
Denish krone	7.50000	7.50236	7.57831	7.57831*	7.57831*
Deutsche mark	3.66000	3.65514	3.48872	3.32811*	3.21978*
French franc	5.55419	5.55119	5.55419	5.55419*	6.01(i)
Suiss franc	4.37287	4.19000	4.16913	3.95052 (am)	3.70565(am)
Dutch florin	3. 62000	3.61707	3.52281	3.47410*	3.35507*
Itelian lira	625.000	625.19	631.342	729(i)	813(1)
Pound sterling	0,416667	199917*0	0.437(i)	0.511(i)	0.534(i)
Noruerian krone	7,11,286	7.14503	7.21500	7.17206*	6.87144*
Austrian schilling	26.0000	25.9789	25.2971	24•4334(am)	23.2778(am)
Swedish krona	5.17321	5.17478	5.22545	5ª46650*	5.50094*
Canadian dollar	J.0470	1,0100	1°07594	1.2478151	1.22924
Ten	360,000	359.232	334.4	339(i)	363(1)
					ל המינה לפשום הסשוםל לסשום

Currencies and reference rates to be used for a currency not supported during the period considered at its par value or central rate notified to the IMF.

J'See calculation in example in Annex II.

20 the basis of market rate vis-à-vis US dollar (annual average, source IFS) and of conversion rate between UR and US dollar.

(1)Indicative value calculated to three significant figures by the Statistical Office of the European Communities on the basis of EC reference currencies only.

(am)Arithmetic mean.

- Example for conversio	on rate between US and US	f for 1.973 -		·
(1) Reference currencies for 1973	(2) Average rate in 1973 for US&1	(3) Reference rate in 1973 for 1 UR	(4) = (3):(2) Calculated rate of 1 UR in \$	
Eelgian/Luxembourg franc	38.97	48.6572	1,24858	
Danish krone	6.0472	7.57831	1.25319 max {	
Deutsche mark	2,6726	3.32811	1,24527	J.24808
French franc	4.4534	5.55419	1.24718	(median)
Dutch florin	2.7950	3.47410	l.24297 min }	
Norwegian krone	5.75348	7.17206	1.24656	
Swedish krona	4.36991	5.46650	1.25094	

Conversion rate for 1973 between USA and the unit of reference (UR) is:

- either 1 UR = US%1.24781 (arithmetic mean)

- or $1 \text{ UR} = \text{US}_{1}^{1}.24808 \text{ (median)}$

ANNEX II