

COMMISSION OF THE EUROPEAN COMMUNITIES

COM(84) 678 final
Brussels, 29 November 1984

COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

ON DEVELOPING THE EUROPEAN MONETARY SYSTEM

AND

DRAFT COUNCIL RESOLUTION

Following their examination in March of the Commission's report on five years of monetary cooperation in Europe (1), the Ministers for Economic and Financial Affairs concluded that progress made towards economic policy convergence and stability of exchange-rate relationships provided some scope for developing the European monetary system.

The discussions held at the informal meeting at Rambouillet in May and the work subsequently carried out by the Committee of Governors and the Monetary Committee confirmed that there was such scope and helped to identify more clearly the technical ways and means of adapting the present system in a balanced manner. Lastly, at the informal meeting held at Dromoland Castle on 15 and 16 September, agreement emerged on the desirability of devising in the near future a set of measures and guidelines that would represent a modest but significant development of the European monetary system and on the need to agree at the same time on the broad lines of a framework for the continued development of the EMS within which such a set of measures and guidelines would fall.

In line with the proposals that it has already presented and on the basis of the work carried out within the specialized Committees, the Commission considers that any such set of measures and guidelines should in the short term help to meet the following three objectives :

- strengthening convergence,
- resuming the financial integration process,
- extending the use of the ECU.

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(1) Communication from the Commission to the Council, COM(84)125 final, 2 March 1984.

1. Strengthening convergence within the EMS

Maximum use must be made of the established Community system of surveillance through a more explicit affirmation of the objectives pursued and stricter application of the existing procedures and instruments.

a) The Council's adoption of the Annual Economic Report should provide an opportunity for a more open and in depth discussion of the macroeconomic measures to be taken and the guidelines to be observed by the Member States in order to ensure the convergence necessary to achieve the objectives of the EMS. The Annual Economic Report should be used more systematically as a reference framework in the Community surveillance procedures. Such use of the Annual Economic Report would require firmer political commitment from the Member States when adopting it. It would give more specific content to the regular coordination exercises, the object of which would be both to ensure the actual implementation of the guidelines adopted and to prepare their periodic updating.

b) More active coordination of economic policies must be sought in three areas :

- In the March report on five years of monetary cooperation in Europe, the Commission noted that, to comply with the requirements of the EMS exchange-rate mechanism, the participants had been obliged to adopt more closely concerted monetary policies, but that the influence of the system in bringing about greater convergence in the other economic policy areas had been only intermittent and generally delayed. The Community system of surveillance must be able to cover all macroeconomic policy instru-

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ments, albeit in different ways, but with the same effectiveness, and it must provide a means of checking regularly the consistency, at national level and within the EMS, of the measures taken in the various fields of economic policy. Similarly, a stricter approach should be adopted in the periodic examinations of the balance-of-payment situations and external indebtedness of the Member States, with fuller and more detailed exchange of information on the policies followed in this area by the national authorities. This would make it easier to assess the extent of which external adjustment policies implemented in the member countries were consistent from the EMS perspective.

- The EMS is intended to achieve two closely linked objectives : greater exchange-rate stability and improved economic convergence. Any signs of incipient strain between participating currencies should therefore logically raise the question whether there are any divergences in Member States' economic policy stances and how such divergences can be remedied. The Commission therefore proposes to initiate a special examination procedure within the Monetary Committee whenever the situation on the exchange markets and the indicators of Member States' relative economic performances suggest insufficient convergence of economic policies.

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- Provision should be made for a similar consultation procedure to be initiated by the Commission or by any Member State whenever a prompt and coordinated response is required in the face of unexpected developments in factors external to the operation of the system, such as the behaviour of non-Community currencies or monetary or financial policy decisions taken in countries outside the Community.

c) Following the examination made at the Council's request of possible changes that would make the medium-term financial assistance (MTFA) mechanism more effective, the Commission concludes, with the Monetary Committee, that MTFA can be used in accordance with Article 108 of the Treaty, which provides the legal basis of the instrument, as a preventive measure in the same situations and under the same economic policy conditions as those stipulated for application of the Community loans mechanism. Consequently, full use should be made of the scope for combined deployment of the two instruments.

- Where one or more Member States do not participate in the grant of MTFA in a particular case because of their reserves or balance-of-payments situation, the possibility of covering the shortfall in contributions by simultaneous activation of the Community loan mechanism should be provided for; the same arrangement should apply in cases where a Member State's mobilization of its claim would entail refinancing from outside the system.

- More generally, where the balance-of-payments situation of a Member State calls for medium-term Community support, the Commission should be able, after consulting the Monetary Committee, to recommend preferential use of one or the other instrument, or an appropriate combination of the two, depending on circumstances.

The Council could decide on arrangements in this regard when it adopts the Commission's proposal for the renewal of the MTFAs arrangements. At a later stage, the Commission will pursue further the examination it has already begun of the possibility of giving the Community's medium-term balance-of-payments support mechanisms a greater role as an instrument of convergence.

2. Resuming the financial integration process

The monetary integration process and the financial integration process are two complementary ways of strengthening the EMS and achieving economic union. Progress along either path facilitates progress along the other; but however significant such progress may be, it will necessarily be gradual. At this stage, the set of measures proposed for developing the EMS should, in so far as liberalization of capital movements is concerned, include three main elements :

- a) A significant easing of the restrictions still applied by virtue of the safeguard clause of Article 108(3) of the Treaty must be sought, and the Commission is currently studying ways of achieving this with the Member States concerned. Some of them have announced initial steps in this direction, and one Member State, which has in fact lifted the restrictions authorized, has announced its intention of formally abolishing them. The Commission has also decided to revise the decisions at present in force authorizing the maintenance of protective measures, to limit their scope and period of validity. The aim is not only to update, in the legal texts, the grounds for the authorization given by the Commission and to consolidate progress so far made, but also and above all to set a date by which the decisions would in principle expire. Authorization to maintain all

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or some of the protective measures in force could be extended beyond that date, after examination by the Commission at the request of the Member State concerned, only if it were established that the balance of payments was still in difficulties or seriously threatened with difficulties.

- b) The Commission's intention is also to clear the way again for a gradual widening of Member States' obligations under Community law in respect of the liberalization of capital movements.

The Council's adoption of the proposals for Directives (1) on collective investment undertakings for transferable securities (CIUTS) would represent a significant and important first step in resuming legislative progress towards a greater degree of freedom of capital movements.

An initial examination carried out by the Commission's departments in collaboration with the Monetary Committee has shown that it is possible to continue along this path and to consider transferring other categories of transactions included in list C (conditional liberalization) of the 1960 and 1962 Directives to lists A and B (unconditional liberalization). These include in particular the following categories of transactions : the issue and placing of securities representing risk capital (shares and other equities), the issue and placing of securities of Community institutions and bodies, and the acquisition of securities not dealt in on a stock exchange. Similarly, there should be an examination of the possibility of extending liberalization

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(1) Proposal for a Directive amending for the second time the First Directive for the implementation of Article 67 of the EEC Treaty (freedom of capital movements). (COM(79)328 final).

Proposal for a Directive coordinating laws, regulations and administrative provisions concerning collective investment undertakings for transferable securities (CIUTS). (COM(77)227 final).

requirements to long-term commercial credits and to some forms at least of mortgage loan operations, in conjunction with the proposals which the Commission is getting ready to present on freedom of establishment and freedom to provide services in this area. The Commission intends to examine more closely the implications of such transfers and to work out the technical procedures for them.

This move, which is necessary to ensure proper legal consolidation of the progress achieved so far within the Community in the liberalization of capital movements, does not remove the need for joint efforts to achieve "de facto" liberalization of certain financial transactions. More specifically, those Member States that maintain restrictions on capital movements (either under safeguard clauses, or because the restrictions are not precluded by the Directives in force) could agree to grant more liberal treatment to certain specific transactions, as the need arises. Such favourable treatment would be granted taking account of the Community interest of the transactions in question. It could, for example, be applied to loan issues intended to finance projects with a specifically European purpose or securities issued by specialized organizations providing risk capital for European industry.

- c) Various national measures taken under exchange control regulations or rules on international banking transactions do not constitute infringements of Community law on the liberalization of capital movements, either because they come within a category that has not been unconditionally liberalized (list D of the 1960 Directive, for example), or because they are not explicitly referred to in one of the headings in the nomenclature of capital movements. Yet, they may be liable to impede payments relating to trade in goods or services or movements of capital normally liberalized under Community law.

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Codification of this area would no doubt pose major difficulties. However, it would be useful if a doctrine on these questions could be established between the Member States and the Commission on the basis of regular discussions and exchanges of information on any measures liable to affect international payments procedures within the Community. It would be appropriate for the Monetary Committee, in accordance with Article 3 of its Rules, to be involved in the surveillance procedures for which the Commission is responsible.

3. Promoting the use of the ECU

More extensive use and wider circulation of the ECU should be encouraged both in the official and in the private sphere.

a) Official use of the ECU

ECUs received by a central bank against its contribution of gold and dollars can be used as a means of settlement between central banks participating in the EMS exchange-rate mechanism, but they are in fact little used in this way. A set of measures should be adopted that would promote the use of the ECU by making it more attractive; these measures should :

- . increase the remuneration of the ECU,
- . set up mobilization arrangements,
- . give "third holders" access to the ECU.

The remuneration of an asset is an important factor in its attractiveness. A change in the existing rules to set the rate of remuneration of net ECU positions (at present an average of official discount rates) at a level derived from market rates would enhance the attractiveness of the ECU

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and confirm its intended role as a reserve asset and thus a means of settlement in its own right.

In addition, since the ECU cannot be directly used in interventions, any central bank requiring intervention resources should be able to mobilize its ECU holdings in exchange for dollars. Such arrangements could take the following form : each participating central bank would have the right to apply to the EMCF to mobilize its net creditor position and part of its ECU allocation; the "mobilizable part" of each ECU allocation would be a given multiple of the share of ECUs created against dollars in total ECUs allocated by the EMCF; the EMCF would procure the dollars requested through swaps with the other EMS central banks, with each of them having to supply dollars only in proportion to (and within the limits of) the amount that it had contributed to the EMCF (20 % of its dollar reserves).

So as to have at its disposal means of intervention other than dollars, the central bank that mobilized ECUs should be able to exchange the dollars obtained for Community currencies. Thus, the mobilization operations would be followed, at the request of the mobilizing central bank, by operations involving conversion into Community currencies, with the central banks whose currencies were requested being presumed to authorize such operations. The currencies requested would be supplied primarily by the issuing central banks, but also (on a voluntary basis and so as to limit money creation in the country whose currency was requested) by the other EMS central banks holding them. Supplemented in this way, this sort of mobilization arrangement would be in accordance with the principle of solidarity underlying the system.

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Furthermore if other official holders had access to the ECU, the unit would be negotiable on a much wider international scale and the participating central banks would have additional scope for mobilizing ECU assets. It would mean giving access to the ECU to certain international monetary institutions, notably the Bank for International Settlements, and to the central banks of countries having particularly close economic and financial links with the European Communities. With higher remuneration, the attractiveness of the ECU for such institutions would be significantly enhanced, and the EMCF could conclude "third holder" agreements with them, specifying the conditions for acquiring, using and repaying ECUs. Council Regulation (EEC) N° 3181/78 of 18 December 1978 relating to the European Monetary System would have to be amended.

These short-term measures will encourage wider circulation of the ECU, but the fact remains that, even under the arrangements envisaged, the ECU could be used to only a limited extent for the settlement of debts, and only in the context of interventions in Community currencies at the margins. Greater importance would attach to measures such as the abolition of the present acceptability limit, which would allow debtors to settle in full in ECUs, and the extension of very short-term financing to intramarginal interventions, which would allow the type of intervention that has proved to be the most common, to be financed under the arrangements at present confined to an increasingly infrequent type of intervention. Both the resolve to push ahead with the development of the system and the aim of

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making the ECU a reserve asset and a means of settlement in its own right mean that these questions must be kept under examination with a view to finding positive answers to them in the near future.

b) Private use of the ECU

The ECU market has now reached a scale that calls for a more cohesive response by Member States to market requirements. The ECU could become a factor in the integration of financial markets in Europe and, consequently, a means of convergence. Certain steps would have to be taken, some immediately, others in the longer term, to allow it to fulfil this role more effectively.

Immediate steps would basically involve :

- . completing the process that has led to the growing use of the ECU as a foreign currency and admitting the ECU to the fixing where it exists;
- . facilitating the effective establishment of an organization for multilateral clearing of ECU bank transfers; although this concerns more directly the banking industry and the official institution that is to act as a clearing agent, it would seem appropriate to signal the Community's interest in this plan;
- . systematizing the statistical recording of ECU transactions so as to allow improved monitoring of how the market is developing; the Bank for International Settlements already compiles statistics on ECU banking transactions, and the Commission intends to do the same for ECU issues, with the help of the national authorities.

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A sound basis would then have to be established for developing such use of the ECU, ensuring that the conditions necessary for the smooth operation of the market were created. In particular, ways would have to be examined of remedying present imperfections and disequilibria, which may be linked to aspects of national rules and regulations or may result from certain practices. For example, the provisions governing the opening of ECU accounts, the acquisition of ECU securities or transactions in ECU securities should in certain cases be reviewed; similarly, full account should be taken of the need to supply the market with component currencies so that the interest rates established on the market do not differ unduly from the rates calculated on the basis of the rates obtaining on national markets.

Furthermore, it would also be in the Community's interest to ensure that the rapid expansion of the ECU market is accompanied by greater diversification. This means firstly geographical diversification, and the recent EEC loan issue on the US market provides a noteworthy precedent here. It also means diversification of instruments, so that a wide range of ECU investment instruments could be made available to non-Community monetary authorities wishing to diversify their reserves. To this end, the EIB and the other Community institutions that make calls on the capital markets could exploit more fully the possibility of using shorter-term borrowing techniques along the lines, for example, of those already used by the World Bank.

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As when the EMS was set up in December 1978, the measures, provisions or guidelines proposed above could be embodied in a Council Resolution that would serve as a point of reference for the formulation of subsequent implementing measures. A draft Resolution consistent with the suggestions made in this communication is annexed.

The proposals presented above form a balanced whole : the balance between the rigour and the solidarity that underlay the EMS has been preserved and a balance has been struck between the rights and the obligations of creditors and debtors; the proposals are a first step towards setting up a European financial market. Adopting this set of proposals will represent significant progress : it will provide visible evidence of the continuing monetary integration of Europe; it will make for a strengthening of the role of the EMS as an essential element of economic discipline and as a factor of monetary stability and solidarity; and it will strengthen the Community's authority in major international monetary and financial discussions.

However, such progress will remain modest. This is inevitable, for convergence between the various economies is improving only gradually. But, while experience in managing the system is a vital basis for further lasting achievement, there is a need now to map out the broad lines of continued development of the EMS. A number of questions must be kept under review :

- . the participation of sterling in the exchange-rate mechanism, the gradual narrowing of the fluctuation margin for the lira, and the conditions for participation of the drachma in the exchange-rate mechanism,

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- . the financing and settlement of intramarginal interventions in Community currencies, and abolition of the ECU's acceptability limit,
- . the removal of the obstacles to the full private use of the ECU in the Member States, and recognition of the ECU as a foreign currency under present monetary and exchange regulations,
- . adjustments to the Community financial assistance instruments so as to give them a more specific role as instruments of convergence within the EMS.

It must be acknowledged that all these matters will have to be cleared up in the near future; bearing in mind past and prospective progress in the coordination of policies vis-à-vis non-Community currencies and in the convergence of economic policies, the Commission can see no objection to a firm commitment to deal with them as soon as possible.

23.11.1984
II/508/84-E

DRAFT COUNCIL REGULATION

On developing the European monetary system

1. Introduction

- 1.1. The Ministers for Economic and Financial Affairs of the Member States, meeting in Council on 10 December 1984, have examined the communication from the Commission on developing the European monetary system and heard reports on this subject by the Chairmen of the Committee of Governors and the Monetary Committee.
- 1.2. The Council considers that five and a half years of experience of operation of the system make it possible, and necessary, to develop the EMS on the basis of greater convergence, a resumption of financial integration and wider use of the ECU. It has agreed to move in this direction by adopting the following provisions, measures and guidelines.

2. Measures to strengthen convergence

If the progress achieved in convergence is to be consolidated, full use must be made of the Community system of surveillance.

- 2.1. The degree of convergence between the economic policies pursued by Member States will be assessed more systematically, in terms of results and means employed, against the guidelines set by the Council in the report that it adopts each year on the occasion of its third examination of the economic situation in the Community.

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- 2.2. So as to ensure more active coordination of economic policies :
- 2.2.1. The consultations that take place within the specialized Committees must provide a means of checking regularly the consistency, at national level and within the EMS, of all the means of action employed by the Member States in pursuing their economic policies. Such consultations must in particular involve an assessment of the extent to which the approaches adopted by Member States with regard to adjustment of their current balances and external indebtedness are consistent with the objectives of the EMS.
- 2.2.2. Where the situation on the exchange market and the indicators of Member States' relative economic performances suggest that there is actual or latent strain due to inadequate convergence of economic policies, the Commission will initiate an examination procedure within the Monetary Committee.
- 2.2.3. Member States will consult one another on the monetary policy measures made necessary by unexpected developments in factors external to the operation of the system. Such consultation will take place on the Commission's initiative or on the initiative of any Member State.
- 2.3. Having just extended the medium-term financial assistance mechanism for a period of two years, the Council invites the Commission to exploit from now on the potential for combined use of that mechanism with the Community loan mechanism providing balance-of-payments support for Member States.

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3. Measures to reactivate the financial integration process

A greater degree of liberalization of capital movements will be sought along the lines of the proposals presented by the Commission in its communication on financial integration (COM(83)207 final, 18 April 1983).

- 3.1. The Council invites the Member States concerned and the Commission to do all they can to reduce significantly the effective scope of the protective measures restricting the free movement of capital. It notes the Commission's decision to carry out a review of the decisions taken under Article 108(3) of the Treaty to limit the scope of application of the derogations authorized and their period of validity.
- 3.2. Determined for its part to adopt as soon as possible the Directive on the liberalization of units of collective investment undertakings for transferable securities and the Directive coordinating national provisions governing such undertakings, the Council invites the Commission to undertake an examination, in collaboration with the Monetary Committee, of the possibility of extending the scope of the Community requirements concerning liberalization of capital movements to other transactions and to present it with proposals along these lines.
- 3.3. Considering that increased supervision of the payments procedures applied in the Community would facilitate application of Community law, and in particular Article 106 of the Treaty, and would prevent the setting up of indirect obstacles to the carrying out of transactions that are normally liberalized, the Council invites the Commission, which is the body responsible for such surveillance, to also associate the Monetary Committee in this work in accordance with the terms of Article 3 of the latter's Rules.

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4. Measures to promote the use of the ECU

4.1. If there is to be wider official use of the ECU, its monetary characteristics must be improved.

4.1.1. The rate of interest applicable to net ECU positions and to balances resulting from very short-term financing operations will be set on the basis of rates representing market rates for the component currencies.

4.1.2. Where it needs intervention currencies, a central bank will be able, through the EMCF, to mobilize ECU assets against dollars up to the amount of its net creditor position and part of its allocation of ECUs. The other central banks will supply the dollars requested in proportion to and within the limits of the amount of dollars which they have contributed to the EMCF.

A central bank which has mobilized ECU assets will be able to convert temporarily the dollars obtained into Community currencies, the EMS central banks whose currencies are requested being presumed to authorize such conversion transactions.

4.1.3. Central banks of non-Community countries and international monetary institutions will be able to acquire, hold and use ECUs in the manner specified by the EMCF under third-holder agreements.

4.1.4. So as to put into effect the measures and guidelines set out above, the Council invites the central banks to amend accordingly their Agreement of 13 March 1979 laying down the operating procedures for the EMS, and the Board of Governors of the EMCF to adopt the necessary decisions; it requests the Commission to present it with appropriate amendments to Regulation (EEC) N° 3181/78 of 18 December 1978.

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- 4.2. The scale and diversity of private use of the ECU call for more uniform treatment of it in the Member States.
- 4.2.1. The Council invites the monetary authorities of the Member States to complete the process which has led to the gradual use of the ECU as a foreign currency, and to admit the ECU to the fixing where it exists.
- 4.2.2. The Council is following with interest present work on the establishment of a multilateral clearing system for ECU bank transfers, and it hopes that such work will soon be successfully completed.
- 4.2.3. The Council welcomes the Commission's plan to set up and administer a system for compiling statistics on the volume of ECU loan issues; it invites the national authorities to help the Commission in this task.
- 4.2.4. The EIB and the other Community institutions that make calls on the capital markets are invited to exploit more fully the possibility of using diversified ECU borrowing techniques, especially short-term techniques.

5. Guidelines for continued development of the ECU

The Council is resolved to press forward with the continued development of the system until transition to the institutional stage, and to strengthen the process of financial integration in the Community. It has undertaken to keep the following matters under review, with a view to dealing with them in the near future :

- . the participation of sterling in the exchange rate mechanism and the conditions for participation of the drachma, and the gradual narrowing of the present margins for the lira;

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- . the financing and settlement of intramarginal interventions in Community currencies and abolition of the ECU's present acceptability limit;
- . the removal of the obstacles to full private use of the ECU in the Member States and recognition of the ECU as a foreign currency for the purposes of present monetary and exchange regulations;
- . adjustments to the Community's financial assistance instruments so as to give them a more specific role as instruments of convergence within the EMS.