European Communities

EUROPEAN PARLIAMENT

Working Documents

1983 - 1984

16 January 1984

DOCUMENT 1-1251/83

REPORT

drawn up on behalf of the Committee on Economic and Monetary Affairs

on the consolidation and completion of the European Monetary System within the framework of the proposals made by the Commission of the European Communities in March 1982 (COM(82) 133 final)

Rapporteur: Mr F. HERMAN

PE 87.798/fin.

English Edition

By letter of 17 February 1983 the Committee on Economic and Monetary Affairs requested authorization to draw up a report on the consolidation and completion of the European Monetary System within the framework of the proposals made by the Commission of the European Communities in March 1982 (COM(82) 133 final).

By letter of 25 April 1983 the committee was authorized to draw up a report on this question.

On 21 June 1983 the Committee on Economic and Monetary Affairs appointed Mr HERMAN rapporteur.

The Committee on Economic and Monetary Affairs considered the draft report at its meetings of 17-19 October, 21-23 November and 20-21 December 1983. It adopted the motion as a whole on 20 December 1983 by 20 votes to 1 with 2 abstentions.

The following took part in the vote: Mr MOREAU, chairman, Mr HOPPER, vice-chairman; Mr MACARIO, vice-chairman; Mr HERMAN, rapporteur; Mr BEAZLEY, Mr BEUMER (deputizing for Mr Franz), Mr von BISMARCK, Mr BONACCINI, Mr BOYES (deputizing for Mr Rogers), Mr DE GUCHT, Mr DELOROZOY, Mr de GOEDE, Mr HEINEMANN, Mr HUTTON (deputizing for Miss Forster), Mr PAPANTONIOU, Mr PURVIS (deputizing for Mr de Ferranti), Mr RADOUX (deputizing for Mr Cingari), Sir Brandon RHYS WILLIAMS, Mr ROGALLA (deputizing for Mr Mihr), Mr SCHINZEL, Mr VAN ROMPUY, Mr VERGEER and Mr WELSH.

This report was tabled on 4 January 1984.

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The Committee on Economic and Monetary Affairs hereby submits to the European Parliament the following motion for a resolution together with explanatory statement:

MOTION FOR A RESOLUTION

on the consolidation and completion of the European Monetary System within the framework of the proposals made by the Commission of the European Communities in March 1982

The European Parliament,

- having regard to the Communication from the Commission of the European Communities on the development of the European Monetary System EMS (COM(82) 133 final),

- having regard to the motions for resolutions on:

  . the creation of a European Savings Account in ECU in all the Community countries (1),
  . the institution of an international competition to devise a symbol representing the ECU (2),
  . the ECU (3),
  . the creation of a fungible European currency (4),

- having regard to the report of the Committee on Economic and Monetary Affairs (Doc. 1-1251/83),

(1) Motion for a resolution tabled by Mr Israel (Doc. 1-425/83)
(2) Motion for a resolution tabled by Mr Sutra De Germa (Doc. 1-436/83)
(3) Motion for a resolution tabled by Mr Purvis (Doc. 1-748/82)
(4) Motion for a resolution tabled by Mr Israel (Doc. 1-1258/82)

A. whereas around 50% of the external trade of the Ten takes place between Member States,

B. whereas it is of considerable importance that relations between the European currencies should be as stable as possible in that they reduce either the cost of exchange risk cover or the losses resulting from changes in the exchange rate,

C. whereas the aim of the EMS was to bring about a greater stability of exchange rates between European currencies and not to reinstate a system of fixed and rigid parities,

D. whereas the EMS has been in operation now for almost five years and whereas this is a sufficient period on which to base a critical assessment of the functioning of the system,

1. Considers that the EMS has functioned relatively well to the extent that it has succeeded in bringing about a relative stabilization of the exchange rates between participating currencies and in effectively reducing their volatility, and also to the extent that the parity realignments have been carried out in an orderly manner as a result of joint deliberations and not of unilateral actions;

2. Observes, nevertheless, that the objectives of internal stabilization and convergence have not been attained to the extent expected, although the last two realignments did give rise to policy adjustments leading to improved convergence;

3. Points out that in the Member States which have experienced more rapid inflation, the fall in effective exchange rates has been more closely contained during the period of operation of the EMS than previously and, in contrast to the revaluation of the strong currencies, has been conducted in a more orderly manner;

4. Notes that while the system has withstood seven realignments and five years of serious disruption, it has also revealed weaknesses and inconsistencies which have held back its consolidation;

5. Considers that the following have been particular weaknesses:

- the method of creating ECUs,
- the lack of coordination of exchange policies vis-à-vis third currencies,
- the fact that the ECU is not widely acceptable and negotiable and that it is non-exclusive and non-convertible,
- the lack of convergence towards internal stability;

6. Considers that the present circumstances warrant the reopening of the debate on technical improvements to and the development of the EMS without delay; this is because

- the last two parity realignments have demonstrably led to pronounced shifts in economic policies towards closer convergence;
- most differences in inflation (except in the case of Greece, which is not a member of the European Monetary System) have been reduced;
- these results have been due to the constraint built in to the operation of the EMS.

Proposals for improving the EMS

A. Improving the mechanisms

7. Proposes that, in order to economise resources and limit interventions in dollars which upset relations between the currencies of the EMS, intervention within the margins by central banks in Community currencies should qualify for very short term financing, which would be subject to a ceiling;

8. Considers it essential that, without waiting for the creation of the European Monetary Fund, the role of the EMCF should be reinforced and broadened by the establishment of a Standing Bureau of the EMCF which would operate under the authority of the Committee of Governors; this Bureau would gradually take over new responsibilities as and when a consensus is achieved on each within the Council of Ministers of Economic and Financial Affairs;

9. Considers that the first task to be entrusted to the Standing Bureau of the EMCF would be the effective and autonomous management of the various existing systems of very short term financing, short-term monetary support and medium-term financial assistance; this would amount to transforming a network of bilateral relations into a multilateral system in which a Community institution could grant on its own behalf and under its responsibility a range of credit facilities which would vary in size and duration according to requirements;

10. Proposes moreover that the Standing Bureau of the EMCF should coordinate interventions in third currencies and, more particularly, policies vis-à-vis the dollar; to achieve this end, the bilateral swap agreements which exist between the Federal Reserve and the main European banks would have to be gradually replaced by a Fed-EMCF swap agreement which could both dampen the volatiblity of the dollar vis-à-vis the ECU and stabilize exchange rates within the EMS insofar as the currency used by the Federal Reserve to reimburse the EMCF would not necessarily have to be the same as the currency borrowed for the purposes of intervention;

11. Requests that the swap agreements which, under the present system, allow the creation of external EMS reserves and which can be unwound at two working days' notice, be consolidated and that transfers in dollars be made permanent, so that the EMCF may use them freely; this would enable the EMCF, at a later stage, to take over responsibility for the issuing of ECUs. These ECUs could be created initially against contributions of dollars, SDRs, national currencies or other reserve assets; later, they could be created against credits. At this stage, it would also be logical for debts and claims between participating central banks to be denominated and settled exclusively in ECUs. Initially, the acceptability level for the ECU in settling debts under very short-term financing between the central banks could be raised to 75%;

B. Convergence

12. Recalls that, under the existing EMS mechanisms, corrective interventions are obligatory or are triggered only when exchange rate stability is threatened, in other words when exchange rates reach the floor or the ceiling;

13. Proposes in this connection that a system of 'warning lights' such as wages costs, inflation differential, interest rates, budget deficits etc.), be studied which, like the divergence indicator, would create a presumption of action by the Member States and an obligation for the Commission to make recommendations. Under such a system the appearance of a divergent trend in the economy of a particular country would become a subject of common concern which would have to be debated in the Council;

14. Calls on the Commission to make greater use of the power of recommendation conferred upon it by Article 11 of the Council Decision of 18 February 1974 (1) should one or more Member States depart from the guidelines laid down by the Council. Systematic and unjustified failure to observe these recommendations should be liable to be sanctioned by the suspension of certain Community credit facilities, such as the NCI or medium-term financial assistance or, at very least, the granting of such facilities ought to be made conditional upon compliance with the recommendations made by the Commission;

C. The opening of the system

15. Agrees with the Commission on the importance of promoting the international use of the ECU, which presupposes the rationalization of the procedures for creating ECUs and improvements to the return on and convertibility of the ECU;

16. Considers it important, in this connection, that approved third parties should be authorized to acquire existing ECUs freely from the participating central banks. The central banks could thereby mobilize their ECUs against dollars to settle their very short-term financing debts in ECUs without the total volume of ECUs in circulation being altered;

17. Is convinced furthermore of the need to authorize the EMCF, during a second stage, to create ECUs for approved third parties against contributions of reserve assets. Taking a broader and longer-term view, the EMCF could issue ECUs for third parties either against deposits of Community currencies or in the form of credits;

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(1) OJ No. L 63 of 5.3.1974

D. Private use of the ECU

18. Notes that the current rapid growth in the private use of the ECU corresponds to a real need, namely developing the use of a European currency as national economies become more integrated and as the number of intra-Community transactions increases;

19. Considers that the ECU offers unique advantages as a medium of exchange across national frontiers, with its complex composition based on member currencies broadly neutralizing particular fluctuations of individual currencies, so giving stability and continuity to the value of trading contracts and the return on investment decisions;

20. Considers that the national monetary authorities should not oppose this spontaneous trend of the markets, although they could monitor it more closely to ensure that it remains subject to the constraints of monetary stability and the general economic interest;

21. Approves unreservedly the Commission's proposals concerning the use of the ECU and in particular:

- the recognition by all the Member States of the currency status of the ECU: the official quotation of the ECU on all the Community's exchange markets would be the culmination of such recognition;

- access by Community residents to transactions in ECU-denominated bonds under the general law;

- an ECU 'trade mark'. The EMCF should lay down general rules and ensure their implementation so as to avoid divergent practices which could harm the development of the ECU;

22. Considers nevertheless that it is necessary to go further and calls:

- on the Commission to put forward early proposals on the organization of a system of multilateral compensation for inter-bank transfers in ECUs and on the introduction of the official quotation of the ECU on all the exchange markets of the EEC;

- on the Member States to issue and circulate metal 1 ECU coins under the authority of the EMCF to popularize their use and to make Europeans more aware that they belong to a European monetary community;

- on the Commission, in preparation for this measure, to organize a competition with a prize of 10,000 ECU being offered for the best design of a symbol representing the ECU;

- for concertation on the creation of a European savings account in ECUs in all the Community countries, as well as credit cards;

- on Member States to liberalize further their own domestic financial markets, by removing for example requirements that pension funds can invest only in domestically-issued equities, so that cross-frontier, private financial transactions can be promoted as a necessary prerequisite to the increased and effective use of the ECU and to legalize and encourage the use of the ECU as an accounting unit for company reports, etc.

23. Expresses its conviction that the development of the ECU is likely to contribute to a better balance in the development of international liquidity. This is because if the ECU were to become a real instrument of payment and a reserve asset it would offer an alternative to Euro-currencies;

24. Reiterates its request to the United Kingdom authorities for the pound sterling to join the exchange rate and intervention machinery of the EMS. In the event the objections and fears expressed in the United Kingdom have been shown to be exaggerated and the objections based on sterling's status as an oil currency and its inevitable volatility could be accommodated by allowing special fluctuation margins (6%) such as those applicable to the Italian lira.

    One effect of such a move would be to help the European central banks to coordinate their exchange rate policy vis-à-vis the dollar by virtue of the special links which have always existed between those two currencies. It would also offer holders of reserve assets who wish to get out of dollars a European alternative other than the deutsch mark, which would alleviate the tension between the deutsch mark and the other European currencies;

25. Instructs its President to forward this resolution to the Council, the Commission and the Parliaments of the Member States of the Community.

B.

EXPLANATORY STATEMENT

INTRODUCTION

It will soon be five years since the EMS was established, a suitable moment to consider whether the system has been able to achieve the objectives that were set for it and, if not or only partially, what its prospects are for development and improvement.

This report is intended to provide the Euroepan Parliament with discussion material drawn from the experience of these 57 months of operation which have seen such a variety of trends and to suggest a number of possible ways forward.

Although it has never officially been consulted on the EMS by the Council, Parliament has given its attention to the subject on numerous occasions[1]. Since direct elections, two major reports have been presented in plenary sitting by the Committee on Economic and Monetary Affairs, namely the Ruffolo report[2] of 11 April 1980 and the Purvis report[3] of 4 February 1982.

The Ruffolo report ended with the following prophetic statements which have unfortunately been borne out by subsequent events :

> 'It is therefore surprising that the European Council (of March 1980) felt able to confirm the deadline of March 1981 for the creation of the EMF, and hence for the transition to the final phase of the EMS, without commenting or even opening any discussion on the political implications of this transition ..... There is therefore a strong likelihood that, when the deadline arrives, the Community will once again find itself unprepared ..... If this should happen, the system would remain precarious and unstable .....'

It could not have been put better - and Parliament has proved a more reliable judge than the Council.

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[1] OJ No. C 267, 11.10.1982, p. 94 (amendment of Reg. 1736/79)
OJ No. C 87, 5.4.1982, p. 76 (adjustment of central rates)
OJ No. C 66, 15.3.1982, p. 45 (resolution on the EMS)
OJ No. C 287, 9.11.1981, p. 85 (resolution on the realignment of parities)
OJ No. C 172, 13.7.1981, p. 98 (resolution on exchange rates)
OJ No. C 172, 13.7.1981, p. 50 (restructuring of economic policies)
OJ No. C 117, 12.5.1980, p. 56 (resolution on the EMS)

[2] PE 63.527

[3] Doc. 1-971/81

Let us hope that the Council bears this in mind in future consultations, when decisions on new steps forward are required.

This report consists of five chapters and a section of conclusions :

Chapter I - The EMS and its background
Chapter II - Assessment of the results of EMS operation
Chapter III - The weaknesses of the EMS
Chapter IV - Proposals for improving the EMS
Chapter V - Private use of the ECU
Conclusions

Chapter I - The EMS and its background

1. There has been much legal discussion of whether and to what extent the creation of an economic and monetary union was embodied or provided for in the Treaty of Rome[1].

The pursuit of common action and policies is dealt with in Articles 103 to 108 of the Treaty. The principles set out there allow for very advanced forms of positive integration, but do not lay down a specific schedule by which this is to be achieved.

This caution on the part of the authors of the Treaty of Rome can be attributed to the economic and political situation then obtaining, which was characterized by :

- the need to select a form of integration acceptable to all the parties concerned;
- the differences of view regarding economic policy, in particular the degree of state intervention in the economy, which hindered any attempt to define a common policy;
- international monetary stability, which made it unnecessary to seek to establish an independent EEC monetary system including neither the dollar nor the pound sterling.

2. Nevertheless, attempts were made in the field of European monetary cooperation to go beyond the somewhat vauge provisions of the Treaty of Rome, the motivation either being concern at the trends in the international monetary system or, within the Community, a kind of domino theory of integration, whereby monetary integration was seen as a logical consequence of integration of the markets.

3. The EMS was thus preceded by other initiatives, directed if not at monetary integration, then at least towards coordination. It seems appropriate to summarize these briefly, since the difficulties they sought to resolve and the new obstacles to which they may have given rise often foreshadow the problems which the EMS now has to confront.

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[1] See, inter alia : R. Monaco - 'Commentario del Trattato instituvo della CEE' (Milan, 1965), p. 35; Cairncross/Geersh/Lamfalusy/Perrili/Uri - 'Una politica economica per l'avvenire della Communita' (Turin, 1965); Loukas Tsoukalis - 'The Politics and Economics of European Monetary Integration' (London, 1977).

A. From the Treaty of Rome to the Werner report in 1970

4. In the early 1960s, under the presidency of Mr Hallstein, the Commission sought to make good some of the deficiencies of the Treaty of Rome by proposing a series of specific measures which would lead to the establishment of a monetary union. In its 1962 Action Programme for the Community during the second stage of the Common Market, the Commission proposed a closer coordination of national economic and monetary policies. The international monetary situation was showing up the first cracks in the Bretton Woods system, and the need for greater stability in exchange rate relations in the Community was made apparent by the revaluation of the mark and the guilder[1] without any coordination at European level.

5. On a recommendation from the Commission, the Council of Ministers decided in 1964 to set up a Committee on Budgetary Policy, a Committee of Governors of the Central Banks and a Committee on Medium-Term Economic Policy; it also adopted a system of preliminary consultation for all major monetary policy decisions and a scheme for mutual assistance, and agreed to further liberalization of movements of capital. The Member States also undertook not to alter the parity of their currencies in future without first consulting their partners. Other proposals contained in the Commission's Action Programme relating to a further series of measures aimed at the permanent fixing of exchange rates between the European currencies and the creation of a European reserve currency were received without great enthusiasm.

6. The debate on monetary questions was not resumed until 1968, when a number of monetary storm-clouds were gathering on the horizon. Early that year, the Prime Minister of Luxembourg, Mr Pierre Werner, put forward a plan of action which proposed the permanent fixing of exchange rates between European currencies, the establishment of a European unit of account and the creation of a European monetary fund.

The Commission memorandum known as the first 'Barre Plan' dates from the same year; this envisaged, amongst other things, mechanisms for short-term monetary support and medium-term financial assistance, agreement on any change in parities, and the possibility of completely eliminating the margins of fluctuation between European currencies[2].

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[1] By 5%, on 6 and 7 March 1961.

[2] Most of the proposals contained in the 'Barre Plan' were adopted by the Council in January 1970, an exception being the mechanism for medium-term financial assistance.

7. Moves towards significant monetary integration were given fresh impetus by the speculation against the French franc (resignation of President de Gaulle in 1969) and in favour of the German mark, and by the signs that the Bretton Woods system was breaking down. At the summit meeting in The Hague in December 1969, the idea was launched of an economic and monetary union in two stages : the first stage would see the effective harmonization of short-term economic policies and the fixing of medium-term quantitative objectives; in the second, a European reserve fund would be set up, to which the Member States would transfer a proportion of their currency reserves. In the months which followed, the Council concerned itself with implementing the declarations made at the summit and, with this end in view, a working party chaired by Mr Werner was instructed to draw up a report.

8. The final version of the Werner report (October 1970) confimed the principle of simultaneous progress towards economic policy convergence on the one hand and monetary integration on the other. On the monetary side, the report stressed the need to harmonize the instruments of monetary policy and to narrow the margins of fluctuation, with a view to gradually arriving at permanently fixed parities.

In addition, a European Monetary Cooperation Fund was to administer the mechanisms for short-term monetary support and medium-term financial assistance. On the basis of this report, the Council adopted a resolution on 22 March 1971 on the achievement, in stages, of economic and monetary union in the Community, setting out the principles for action during an initial three-year period; such action was to include a mechanism for medium-term financial assistance and the gradual narrowing, as from 1 June 1971, of the margins of fluctuation between European currencies.

From the creation of the 'snake' to the EMS

9. However, between May and President Nixon's decision of 15 August 1971 officially suspending the convertibility of the dollar into gold, the lack of monetary union in Europe became painfully clear : at the Council meeting of 19 August 1971, only the Benelux countries decided to keep the exchange rate fluctuations between their currencies inside the previous margins and to float jointly against the dollar.

10. Following the Smithsonian Agreement of December 1971, the fluctuation margins for the exchange rates of European currencies against the dollar were extended to 2.25% of the new dollar parities in each direction. This meant that the maximum fluctuation between two European currencies could be 4.5% at any given moment and 9% over a period of time. This situation was clearly a potential danger for the common agricultural policy; moreover, distrust of the dollar had become widespread.

To improve matters, the Council's decisions of February and March 1972 (contained in the 'Basle Agreement' between central banks) set at 2.25% the maximum spread at any given moment for the exchange rates of two European currencies (the 'snake in the tunnel'). Given the margin allowed between any one of those currencies and the dollar, the width of the snake (2.25%) was half that of the tunnel (4.5%). In addition, the principle was adopted that intervention to keep European currencies within the snake would be effected in European currencies; intervention in dollars would no longer be permitted except to prevent the snake leaving the tunnel. In May, the pound sterling, the Irish pound and the Danish krone joined the snake.

11. However, following a series of unsettling events in the international arena, a number of European currencies left the snake, and in 1973 the Commission proposed that, while the snake should be preserved, it should be withdrawn from the tunnel. This system of European currencies floating jointly against the dollar allowed for changes in parities within certain limits and under certain conditions (stable but adjustable parities, as in the EMS). In the meantime, the European Council of October 1972 in Paris had provided for the creation of the EMCF.

On 12 March 1973, six countries (Germany, France, Denmark and the Benelux countries) joined the new snake, while Italy, the United Kingdom and Ireland decided not to participate. This 'zone of stability' also attracted Norway and Sweden, whose currencies joined the snake in March 1973.

12. In March 1973, the first oil crisis and the serious difficulties which ensued led to the withdrawal of the French franc from the snake. Thus in January 1974, of the nine Member States of the Community, only five remained in the snake : Germany, Denmark and the Benelux countries[1].

Between 1973 and 1977, progress towards economic and monetary union was virtually non-existent.

13. However, in order to counter the risk of the disintegration of the common market in agriculture, and to discourage protectionist trends, various European political figures sought to revive the process of monetary integration :

- in September 1974, Mr Fourcade, the French Finance Minister, proposed a scheme of extended joint floating, i.e. the creation around the snake of a broader and more flexible margin of fluctuation which would include those European currencies outside the snake. Mr Fourcade also suggested that the responsibility for intervention should not rest solely with the central bank whose currency had reached

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[1]The Swedish krona left the snake in August 1977 and the Norwegian krone in December 1978.

the intra-Community floor rate;

- Mr Tindemans, the Belgian Prime Minister, proposed in his report of December 1975 the creation throughout the world of large-scale zones of stability within which stable exchange rates would be maintained;
- in February 1976, the Dutch Finance Minister, Mr Duisenberg, proposed the establishment of 'target zones' for exchange rates : if a currency left its target zone, this would set in train a consultation procedure involving the Commission and the other Member States; the proposal was taken up again and further elaborated in 1978 by Mr van Ypersele;
- Mr Roy Jenkins, President of the Commission, stated in Florence in October 1977 that monetary union was the best means of securing economic recovery.

14. On the basis of these earlier proposals, the various European Council meetings of 1978[1] established a more unified system of joint floating in relation to outside currencies, grouping eight Community countries together in the EMS[2].

B. The European Monetary System

15. In this section, a brief account will be given of the obligations involved in membership of the EMS, according to the European Council's resolution of 5 December 1978, and of how these differ from the mechanisms of the 'snake'.

Some similarities do exist (one currency may not fluctuate in relation to another by more than 2.25% around their bilateral parity - 6% for the Italian lira; when a currency reaches the limit of its permitted margin in relation to another currency, the two central banks are obliged to intervene); there are also major differences, however :

- the role of the ECU;
- the divergence indicator;
- the institutional phase of the EMS.

16. The ECU (European Currency Unit) is a denominator of the 'basket' type. It lies at the centre of the EMS, and its composition is identical with that of the EUA (European Unit of Account) created in March 1975. However, the ECU is not solely a unit of account. It is also used as the denominator for the exchange rate mechanism[3]

[1] Copenhagen, 7 and 8 April; Bremen, 6 and 7 July; Brussels, 4 and 5 December

[2] The United Kingdom participates in the EMS, but not in the exchange rate mechanism. When Greece joined the Community in 1981, it chose not to participate in the EMS.

[3] The value of the ECU in a Community currency is equal to the sum of the exchange values in that currency of the amounts of all the currencies contained in the ECU basket.

as the basis for the divergence indicator[1] and as the denominator for operations in both the intervention and credit mechanisms. ECUs are supplied to the central banks by the EMCF against the deposit of 20% of the banks' gold and dollar reserves, by means of three-month revolving swap arrangements.

17. The divergence indicator, based on the ECU, is used to detect divergences in the exchange rates of currencies by reference to the Community basket. It should be noted that this formula (the 'Belgian compromise') still involves the exchange rate mechanism and obligations to intervene based on the grid of bilateral rates, but also entails a mechanism based on the divergence of one currency in terms of all the others in the basket. A 'threshold of divergence' is set for each currency at 75% of the maximum divergence spread; when that threshold is crossed, there is a 'presumption' that the authorities concerned will correct the situation (not an obligation to intervene).

Attention should also be drawn to the credit mechanisms which exist :

(a) 'very short-term financing' is intended to assist currencies in remaining within the margins of fluctuation. For this purpose, the central banks open credit facilities for each other through the EMCF in their respective currencies, unlimited in amount but for a very short term (45 days after the end of the month of intervention);

(b) 'short-term monetary support' is an agreement between central banks which, unlike the facility described above, is not restricted to those countries participating in the EMS exchange rate mechanism. This support is available where a need has arisen for short-term financing in consequence of a temporary balance-of-payments deficit[2];

(c) 'medium-term financial assistance' is granted by Member States for a period of 2 to 5 years in cases of severe balance-of-payments difficulties[3]. This aid is conditional, and the recipient country is obliged to give certain economic and monetary undertakings.

18. The timetable for transition into the institutional phase has not been observed and its implementation is encountering serious resistance. For this reason, the Commission proposed measures in March 1982 to expand the non-institutional aspects of the EMS. The substance of these measures and the objections which they are encountering will be discussed in detail later in this report.

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[1]The exchange values of the ECU in a Community currency vary depending on whether one takes the bilateral central rate for each currency or its market rate; the spread between these two rates is used as the basis for calculating the divergence indicator.

[2]The period of credit is three months, and may be renewed twice. The amount available is 14 thousand million ECU.

[3]The amount of credit available is 14.1 thousand million ECU.

Chapter II - Assessment of the results of EMS operation

1. The operation of the EMS has to be assessed with reference to the objectives of the system and also in terms of the hopes and fears it raised.

The aim was twofold : greater stability of exchange rates between the European currencies (external stability) and greater convergence of the participating economies towards internal stability; greater stability of exchange rates did not mean restoring a system of permanently fixed parities, but a system of stable, adjustable parities.

Three fears were expressed :

- in the light of experience with the snake, many observers took the view that the EMS would not last long before one or more of its members felt obliged to withdraw.

Such critics thought it unreasonable to hope that economies with such disparate performances could allow a system of stable parities to work normally. Movements of capital would soon break down the flimsy barriers set up by the central banks against market swings, and a series of panic devaluations could be expected.

The system would thus soon collapse like that of Bretton Woods. The only alternative was seen as a 'crawling peg' system, but this was incompatible with the aims of internal and external stability set for the EMS.

- Others feared that the discipline of the system would have too great a deflationary effect, especially in countries with a weak currency. The effects of such a policy on economic activity and employment would be politically intolerable and would eventually destabilize the political system in these countries.

- Conversely, many critics of the EMS thought that the obligation to intervene imposed on the central banks of countries with a strong currency would deny them the possibility of acting independently to control money supply, and thus to keep the trend of costs and prices inside their own targets for stability.

The same critics feared that the EMS and the proliferation of ECUs would be an additional source of international liquidity and thus fuel inflation.

2. Before analysing the results in detail, two comments should be made :

- when the EMS was established, the economic conditions in Europe were much better than in the years that followed. The first oil crisis had been absorbed and the

Community's balance of payments was once again in surplus; inflation rates, although still too high, had fallen in all countries and the differences between these rates had narrowed. The rates of investment and economic activity had recovered, albeit to an inadequate extent.

The second oil crisis seriously disrupted this movement towards a new balance. Both the widely varying dependence of Member States on oil imports and the diversity of the policies adopted to combat balance-of-payments difficulties encouraged the divergence of economic trends and increased inflation rate differentials.

In 1981, the joint intervention by the United States, Switzerland and Germany to stabilize relations between the dollar and the mark came to an end. The increased fluctuations of the dollar which ensued had a disruptive effect on the relations between European currencies.

- Given these destabilizing factors, it is hard to tell to what extent the EMS and its mechanisms have contributed to harmonizing European economies and stabilizing exchange rates. To form a true picture, it would be necessary to compare the actual events with what would have happened if the EMS had not existed.

A reconstruction of that kind is impossible. To avoid inaccuracy, however, the final assessment must take this element into account.

1. - <u>External stability</u>

3. Despite the international atmosphere of instability, the second oil crisis, the divergence of economic policies and the differences in rates of inflation, the EMS has made the exchange rates between participating currencies relatively stable and has appreciably reduced their volatility.

The short-term variability of exchange rates between EMS currencies has decreased both in relation to previous years and vis-à-vis non-participating currencies such as the pound, the dollar and the yen.

It is also clear that in countries like France, Italy and Ireland, which have experienced more rapid inflation than their partners, the decline in effective exchange rates has been contained better during the period of operation of the EMS than was the case before.

The EMS has thus brought to an end the 'over-adjustments' which had occurred in the past and has encouraged discipline against inflation.

4. This relative stability has been produced by the mechanisms of intervention and by the adjustment policies pursued by the Member States.

The central banks have made interventions either in dollars or in Community currencies.

During the first four years of the EMS, over 60% of interventions were made in dollars, in particular those by the Bundesbank. This was due to a desire to maintai a degree of stability between the mark and the dollar, and to the concern of the central banks to intervene before the compulsory intervention points were reached so as to discourage any move towards speculation. This latter type of intervention has also taken place in dollars because the consent of the central bank for the intervention currency is needed in the case of intervention within the margins.

Nevertheless, almost half the intramarginal interventions were made in EMS currencies, which indicates a high degree of cooperation between the central banks.

Although relatively high, intervention by the central banks has never approache the limits of the system. Hence there has been virtually no recourse to short-term monetary support or medium-term financial assistance (except that for France in 1983).

As for very short-term financing, it should be noted that this has not led to a build-up of substantial credit or debit positions in ECU within the EMCF.

The sum of the net credit or debit positions within the EMCF has never exceeded 10% of the volume of ECUs created under the swap arrangements provided for in the EMS.

This seems to indicate that, to make good their balance-of-payments deficits, the Member States have tended to incur debts on the international capital market rather than avail themselves of medium-term financial assistance, and that they have made other timely adjustments to avoid increasing the pressure on exchange rates.

5. Besides the intervention mechanism, the central banks have used interest rates as an important instrument of exchange policy.

When alterations in exchange rates are not anticipated by the markets, short-term movements of capital are primarily influenced by the differences between nomina interest rates. This fact accounts for the distinct convergence of short-term interest rates witnessed in 1980 and 1981. If interest rates have tended to diverge again in 1982 and 1983, this is because operators are less confident of the stability of central rates and are not concentrating so exclusively on nominal rates of interest.

6. If the EMS has been able to bring about relative stability in exchange rates without exhausting the scope for intervention provided for in the support mechanisms, this is because of the versatile and flexible elements built into the system.

Amongst these, it should be noted that the maximum spread permitted is 2.25% - 6 % for the lira - which means that variations within the margins can be twice this figure. For example, between January and May 1981 the mark rose from the lower to the upper limit (i.e. 2.25%) while the French franc fell from the upper to the lower (again, 2.25%). The divergence between the two currencies thus reached 4.5% without the central rates having to be modified.

Most important in terms of flexibility, however, are the periodic adjustments of the central rates. The parities within the EMS are 'stable but adjustable'. This means that if the gap between two currencies in the system becomes too wide and remains undiminished despite substantial intervention or changes in interest rates, the central rates are then realigned by mutual agreement.

Since March 1979 there have been seven changes in central rates. These are listed in the table on the following page.

CHANGES IN EMS CENTRAL RATES

1979	24 September	DM	revaluation	2%
		Danish krone	devaluation	2.9%
	30 November	Danish krone	devaluation	4.8%
1981	20 March	Italian lira	devaluation	6%
	4 October	French franc	devaluation	3%
		Italian lira	devaluation	3%
		DM	revaluation	5.5%
		Dutch guilder	revaluation	5.5%
1982	21 February	Belgian franc	devaluation	8.5%
		Danish krone	devaluation	3%
	13 June	French franc	devaluation	5.75%
		Italian lira	devaluation	2.75%
		DM	revaluation	4.25%
		Dutch guilder	revaluation	4.25%
1983	21 March	French franc		4.5%
		Italian lira	devaluation	2.5%
		Irish pound		3.5%
		DM		5.5%
		Dutch guilder	revaluation	3.5%
		Danish krone		2.5%
		Belgian franc		1.5%

All these operations, except perhaps the last, were carried out calmly and rapidly. The need to secure mutual agreement made it possible to avoid a sudden round of competitive devaluations like those which took place before the war. The speed with which decisions were taken also prevented delays in adjustments from building up, a frequent occurrence under the Bretton Woods system.

The first three realignments caused little disruption to the trend in exchange rates since they were absorbed within the fluctuation margins. The change of 24 September 1979 was caused by external pressure on the system owing to the fall of the dollar.

Agreement on the last three realignments was more difficult to secure, because each was combined with often unpalatable measures designed to increase convergence towards internal stability. The aim was to bring prices and incomes under better control, and to curb the deficits in public finances and social security systems.

In addition, the countries whose currencies had been revalued decided to relax monetary constraints to some extent.

The evidence therefore shows that, without the EMS, those countries with weak currencies would have had no incentive to take the often difficult steps needed to bring their economic performance into line with the Community norm.

7. As regards the divergence indicator, assessments of its role vary widely.

J. van Ypersele takes a favourable view[1] :

'The discipline of the system has had a preventive function, with policies being adopted before the divergences became too great ..... in this way, the scale of intervention has been reduced.'

The International Monetary Fund is far more cautious[2] :

'The divergence indicator remains an ambiguous concept in that it tends to promote not convergence towards monetary stability but convergence towards a norm in price trends and monetary developments. This is why it has not performed the role expected of it.'

The least we can say is that if the aim of the divergence indicator was to ensure that the burden of adjustments was shared by those countries with strong currencies, that aim has been only very partially achieved.

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[1] op. cit. p. 80

[2] IMF Occasional Paper 19, May 1983 - 'The EMS : the experience 79-82', p. 15

2. - Convergence towards internal stability

8. The declared aim of the EMS was not only to promote a zone of monetary stability but also to encourage greater convergence of economic policies and performance in order to facilitate the integration of European economies. Before examining the results of the EMS in these terms, some comment should be made on what is meant by convergence.

9. While the general concept is easy enough to define (a process in which economic variables become aligned), it is quite ambiguous when used without a clear indication of which variables are involved[1].

In short, the monetary convergence dealt with here is essentially concerned with the trends in costs and prices. The reduction of differences in economic structures or other variables may be an end in itself, but is not an essential pre-condition for monetary integration. This is shown by the fact that within large countries there are significant regional disparities, possibly greater than those between such countries themselves. It is in this respect that the present report differs slightly from that by Mr Ruffolo, where the emphasis was placed on structural convergence and the elimination of regional disparities.

10. The aim of convergence, as thus defined, was not achieved until 1983, a year in which first policies and then performance showed a less divergent trend.

The figures show that the differences between inflation rates increased following the entry into force of the EMS and did not narrow again until 1983. This disquieting paradox can be explained, however.

11. Between 1976 and 1978, Europe overcame the effects of the first oil crisis. Balance-of-payments deficits were rectified, inflation was gradually brought under control and the inflation rate differentials between Member States became narrower.

There then followed the second oil crisis, almost coinciding with the entry into force of the EMS. The varied responses of governments to this fresh upheaval led to an abrupt return to divergent costs and prices.

In normal conditions, the operation of the EMS mechanisms should have encouraged greater convergence of rates of inflation. This did not happen, but not because those mechanisms functioned wrongly. The explanation lies elsewhere.

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[1] Political misuse of the concept has gone so far as to embrace the question of Member States' contributions to the Community budget.

12. When France, Italy and Ireland joined the EMS, depreciation in the exchange rates of their currencies had more than compensated for the rise in internal prices. This gave them a competitive advantage which resulted in a relatively favourable balance-of-payments situation.

Germany, on the other hand, had its largest external deficit in 1980 since the establishment of the Community. At that time, the mark was at its floor rate, the French franc at the opposite pole; inflation was high in France and low in Germany. Similarly, the Belgian franc was often at its floor rate, despite a level of inflation which remained amongst the lowest in the Community.

13. It can be deduced from this that the behaviour of exchange rates was influenced more by trends in the balance of payments and interest rates than by disparities in rates of inflation, at least until 1981. This is why inflation differentials were able to widen for a certain period without producing too much pressure on exchange rate relations.

14. The situation changed at the end of 1981, however; balance-of-payments positions were reversed and the stability of exchange rate relations in the EMS was disrupted. With no futher latitude available, disparities in inflation had a more direct impact on exchange rates. Rather than carry out politically awkward adjustments, the Member States preferred to take advantage of the flexibility provided by the EMS and thus to realign the central rates.

15. Four realignments in 18 months was the price paid for this facility; it has not enhanced the credibility of the system, nor spared governments the task of carrying out adjustments which have had to be accepted in order to permit a return, at the end of 1983, to a position of greater convergence and relative stability.

A lesson must be drawn from this. The mechanisms of the EMS must not give preference to external stability. They should also be aimed at convergence towards internal stability, and should entail obligations to take action when that stability is threatened.

Chapter III - The weaknesses of the EMS

1. Under the agreements reached by the European Councils of Copenhagen (April 1978), Bremen (July 1978), Brussels (December 1978) and regularly confirmed until the March 1980 European Council, the EMS should have reached its institutional stage within two years of its inauguration, that is in March 1981.

'We remain firmly resolved to consolidate, not later than two years after the start of the scheme, into a final system the provisions and procedures thus created. This system will entail the creation of the European Monetary Fund as announced in the conclusions of the European Council meeting at Bremen on 6 and 7 July 1978, as well as the full utilization of the ECU as a reserve asset and a means of settlement.'[1]

2. This deadline was not met. The Luxembourg European Council (December 1980) decided that consolidation would take place when appropriate. Why this postponement? The reason claimed was that changes to national legislation (and even constitutions) would be required to set up the EMF and for the irrevocable transfer of 20% of central bank reserves in exchange for ECUs. Neither France nor Germany wanted public debate on these delicate matters during the run-up to important elections.

In addition to these doubtless real but ephemeral political considerations, there remained a fundamental disagreement between the central banks, the strongest and most independent of which were not, and still are not, inclined to give up to the EMF even a small part of their jealously guarded prerogatives. Their arguments against consolidation of the EMF are based on their perception of real failings, whcih however they refuse to do anything about even though the remedies lie in their own power.

What is even more serious is that, since it was agreed to postpone consolidation, any proposals for improving the EMS, even if they do not involve any institutional reinforcement, are automatically rejected as being part of this postponed consolidatic The Ministers of Finance make the best of it 'the EMS has worked well so far. Let's not give ourselves grey hairs trying to improve it ...'.

3. Nothing could be more wrong.

Although, as we saw in the preceding chapter, the EMS has worked relatively well so far despite the insufficient convergence, it has done so partly because of the flexibility of its machinery but also because of a favourable conjunction of circumstances which might not recur.

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[1] European Council resolution of 5 December 1978.

As the BIS put it in its 52nd annual report, the absence of damaging external shocks to the stability of the system since March 1979 could be explained by the strength of the dollar vis-à-vis the DM during most of this period. The system's sensitivity to external disturbances would be tested only if there were a new period of prolonged weakness of the dollar against the DM ... In future, however, stability would have to result from obtaining and maintaining downward convergence of inflation rates.[1]

In five years of operation the EMS has revealed a number of weaknesses and a degree of fragility. There are four weaknesses :

- the system for creating ECUs
- the lack of coordination of external exchange rate policies
- the ECU's relative lack of acceptability and negotiability, and its non-exclusiveness and non-convertibility
- the lack of convergence towards internal stability.

4. The present system for creating ECUs is not very satisfactory. The central banks transfer 20% of their gold holdings and 20% of their dollar reserves to the EMCF in the form of 3 month swaps against ECUs. There is an agreement to renew the swaps every 3 months. On each quarterly renewal there are volume adjustments to take account of the variations in the central bank reserves and value adjustments to take account of variations in the ECU price of the assets contributed. The 27,000 million ECU created in March 1979 became 50,000 million in April 1981, 40,000 million in April 1982 and 38,000 million in July 1982 and 42,000 million in December 1982. ECUs are thus being created blindly, at a rate determined not by the Member States' borrowing needs, but by variations in the price of gold and the rate of the dollar. The creation of ECUs is thus potentially inflationary and always arbitrary.

Moreover, the renewal of the three-month swaps makes the ECU unstable, which is unlikely to encourage its wider use.

Finally, as Mr J. van Ypersele puts it, the EMF plays a purely passive role and has no discretionary power over either the quantity of ECUs created nor the use of the reserves contributed. It cannot therefore freely secure the reserves against which it issues ECUs.

The precarious status and limited role of the ECU tend to exaggerate the difficulties arising from the fluctuations in the dollar and lack of concertation when

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[1] BIS 52nd annual report, June '82, p. 171

required. For if the role of the ECU as a reserve asset were extended, and it partially replaced the main EMS currencies in that respect, the external tensions between the European currencies would probably be reduced and it might become easier to coordinate exchange-rate policies towards other currencies.[1]

5. The EMS's second weakness is the lack of coordination of exchange rate policies in respect of other currencies.

As we have already seen, the tensions between the EMS currencies are not solely due to differing rates of inflation or trade imbalances. They frequently lie outside the EEC, as short-term capital inflow is unevenly distributed among the European currencies. The most attractive currencies are naturally the most stable ones and the most easily negotiable. In plain language, movements of money from and to the dollar concentrate on the DM, if only because there is an active market in that currency in New York.

The resulting fluctuations in the DM are essentially unrelated to the economic variables affecting relations between the Community countries. We also know that for interventions within the margins, the central banks primarily use the dollar, uninfluenced by trends in the US balance of payments. In their turn these fluctuations may set up tensions within the EMS exactly conteracting the aims of the original intervention.

6. The third weakness of the EMS is that the ECU is not widely acceptable or negotiable, and is non-exclusive and non-convertible.

In the event of intervention on the margins, the debtor bank may choose the very short-term credit facilities. If it does, the debt is denominated in ECU, but may be settled before term in the currency of the creditor bank.

If the debt is not repaid early, the creditor bank is obliged to accept no more than 50% of the repayment in ECU. If the financial mechanism is not used, the transaction is not denominated in ECUs but the two parties may agree that it be wholly or partly effected in ECUs.

In the case of intervention within the margins, the very short-term credit facilities are not automatically available, but may be granted with the agreement of the creditors, in which case the rules set out above will apply.

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[1] J. van Ypersele, 'Le système monetaire', in 'Perspectives Européennes'

Of course, these various types of transactions do not rule out settlement in other than ECUs where the parties agree. It is thus not exclusive and acceptance is unconditionally required only up to 50% of a debt when repayment is due.

The present arrangements for the transitional period prevent the EMCF from converting the ECU into other reserve assets except where the revolving swap arrangements can be terminated. This mechanism gives the EMCF no discretionary or supervisory powers over the reserve holdings, management of which is still entrusted to the contributor banks.

Moreover, at two working days notice, the latter may withdraw their holdings, unwinding the swap arrangements. The EMCF is thus unable to convert a net ECU position by cash buying or selling operations.

However, the ECU is negotiable as between the central banks. If two of them agree, they may use the ECU in cash transactions to acquire either other reserve assets or Community currencies, and in turn these currencies and holdings may be used to acquire ECUs. However, these transactions may not be carried out solely to diversify the reserves.

7. Last but not least, the main failing of the EMS during its first five years, and one which its opponents always raise, has been the absence of convergence towards internal stability. By this we mean the varying assessment of prices and costs in the economies of the Member States.

As we saw in Chapter II, these divergences, which can be partly explained by the disruption of the world economy, feed on the different policies and procedures used by the national governments to make the internal adjustments forced on them by external events. When amplified and perpetuated, these disparities cannot be absorbed simply by the exchange rate mechanisms and the related financial facilities; changes have to be made to the exchange rates within the EMS. If repeated too often, these changes are damaging to the credibility of the system and a serious obstacle to its development.

The existing machinery of the EMS exclusively favours external stability and exchange rate stability, whether in bilateral exchange rate trends or in the operation of the divergence indicator. Only when this stability is endangered do the monetary authorities feel obliged to act.

However, nothing in the EMS obliges them to act when inflation rates, budget deficits, growth in money supply or wage costs diverge, so long as the value of the currency is unaffected.

The rules of the EMS are only indirectly and secondarily conducive to convergenc
towards internal stability.

HAPTER IV - Proposals for improving the EMS

. Since its inception, the EMS has undergone criticism and analysis. The Commission, n cooperation with the Monetary Committee, and the Committee of Governors have onstantly deliberated on ways of improving the system. These discussions have shown he vigorous differences of opinion between the strong and the weak currency banks, etween those who believe that the convergence of economic performance must precede strengthened EMS and those who believe that any strengthening of the EMS will ncourage convergence, between the governors with independence and those more subect to political influence.

!. Despite these difficulties, the November 1981 London European Council called or closer cooperation between Member States.

The Commission hoped that at a future meeting the European Council would take tock of the system and outline its future.

On 14 December 1981 the Council of Ministers for Economic Affairs and Finance tated that it would be premature to proceed to the institutional stage. It was not ossible at that point and in that economic climate to establish the EMF or to give it permanent reserve assets in return for ECUs.

On the other hand, improvements to the system and its mechanisms were possible. The Commisison, in conjunction with the Monetary Committee and the Committee of Governors, should make proposals to that effect.

3. The Council of Ministers for Economic Affairs and Finance of 15 February 1982 concluded that technical improvements were possible within the existing institutional framework, but that progress would have to be made on convergence first. The Commission had suggested, and the Council accepted, four areas in which improvement could be made, as follows :

- mechanisms for issuing and accepting the ECU and arrangements for intervention within the margins,
- the private use of the ECU,
- greater convergence,
- opening of the EMS to the outside world.

On 15 March 1982 the Commission sent a communication to the Council on the subject.

4. Neither the Monetary Committee nor the Committee of Governors nor the Commission managed to break down the resistance of the Bundesbank and the Nationale Bank which had strongly objected to the Commission's modest but logical proposals. As the chairman of the Committee of Governors put it in a note verbale to the Council[1], technical improvements to this or that part of the system could not be regarded as a viable alternative to greater convergence of economic policies.

5. At an informal meeting on 17 May 1982 the Council of Ministers for Economic Affairs and Finance did however give its political agreement to some of the Commission's suggestions, especially with regard to the private use of the ECU, measures to encourage convergence and some aspects of relations between the EMS and the outside world.

It is therefore surprising that the Commission waited over a year, until 24 May 1983, before submitting a brief communication to the Council on promotion of the international role of the ECU.

The communication[2] concludes by asking the relevant authorities to express 'their intention to take all the measures necessary to ensure that ECU operations are treated, in the context of their internal regulations, as foreign currency operations.'

It would be difficult to ask for less.

6. The political situation as well as the wide economic divergences have probably not been conducive to a strengthening of the EMS.

The presence of Helmut Schmidt, Giscard d'Estaing and Roy Jenkins (three figures whose abilities in the monetary field enabled them to impose their wishes on the experts), which played such a major role in the establishment of the EMS, has not been repeated in their successors who, let it be said in mitigation, had other urgent problems to cope with.

Nevertheless, developments are taking place.

7. Your rapporteur believes that present economic conditions justify an immediate new start on technical improvements to and strengthening of the EMS. The last two exchange rate realignments have caused considerable changes in economic policies

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[1] Note verbale to the Council of Ministers of Economic Affairs and Finance, 15 March 1982

[2] COM(83) 274, 24 May

ading towards greater convergence. Not only have monetary policies tended to onverge, but budgetary strategies and incomes policies have done the same. The ifferences between rates of inflation, except in the case of Greece which is not art of the system, have been reduced. The problem of convergence, so frequently sed as a pretext for leaving untouched the present system, is in the process of eing solved, and no one disputes the fact that these results have been produced by he constraints embodied in the EMS.

It is therefore time to strengthen it. The European Parliament, although not n possession of all the technical information, should not confine itself to vague xhortations.

It could back up the following proposals.

. - Convergence

. As we have seen, in the present EMS, corrective intervention is triggered only hen the system's external stability is jeopardized.

Intervention should be possible at an earlier point.

We are therefore proposing that a system of warning lights be studied which, ike the divergence indicator, would prepare the Member States for action and equire the Commission to make recommendations.

Indicators could include wage costs, public spending deficits, interest rates, alance of payment trends, rates of investment and, most important of all, the rate of inflation (or to be more precise, the differences between rates of inflation).

Under a system of this kind, a divergent economic trend in a particular country would become a matter of common concern which would have to be debated in the Council.

9. The Commission's role is based on Article 11 of the Council decision of 18 February 1974 which states that where a Member State is pursuing 'economic, monetary and budgetary policies departing from the guidelines laid down by the Council or entailing economic risks for the Community as a whole, the Commission may send a recommendation to the State concerned'.

Parliament asks the Commission to consider itself obliged rather than authorized to do so.

Persistent and unjustified refusal to comply with such recommendations should be liable to be sanctioned by the suspension of certain Community financial facilitie such as the NCI or medium-term financial support or at the very least such financial facilities should be made subject to compliance with the Commission's recommendations

2. - Improving the mechanisms

10. At present a central bank's use of a Community currency for intervention to defend its exchange rate within the margins is subject to the express agreement of the central bank whose currency is requested.

In the absence of this agreement, or of the desire to ask it, the bank will intervene in dollars, which undermines the coherence of the EMS central banks' attitudes towards the dollar.

Alternatively, if no intervention is made within the margins, the currency under threat slides until it reaches its bilateral margin, at which point the central banks are obliged to intervene and the amounts may be far greater than what would earlier have been sufficient to prevent the bilateral margins being reached.

11. For both these reasons, that is to economize on the size of intervention and to limit dollar interventions which disrupt relations between EMS currencies, it must be made possible to use Community currencies for intervention by the central banks within the margins.

Such interventions would normally be carried out in the currency for which the premium or below-par rating in respect of the diverging currency was the most advantageous, but other options would not be excluded. These interventions, which could qualify for very short-term financial support, would be subject to a ceiling.

3. - Changes in the EMCF

12. Without waiting for the European Monetary Fund to be set up, the role of the EMC which is at present restricted to book-keeping and legal affairs could be strengthene and broadened by setting up a kind of EMCF standing bureau working under the authority of the Committee of Governors rather like a management board working by delegatio from a board of directors and responsible to it.

This bureau would gradually take over new responsibilities as they obtained a consensus on the Council of Ministers of Economic Affairs and Finance.

. Its first responsibility would be the efficient and independent management of e various existing systems of very short-term financing, short-term monetary support d medium-term financial assistance.

At present the EMCF is no more than a legal structure with no genuine independence, nfined to a bookkeeping role.

If the EMCF is given real responsibilities in managing the Community credit chanisms, this would produce a multilateral system from the present network of lateral relations, and a Community institution would be able to act in its own me and on its own responsibility in granting longer or shorter credit on a wider narrower basis as necessary.

Giving the EMCF this responsibility would be no more than confirming the mandate nferred on it by Article 3 of the April 1973 regulation setting it up, at least as gards very short-term and short-term credit.

. The EMCF standing bureau would also be responsible for coordinating interventions other currencies, and more particularly for coordinating policies towards the llar.

To this end it would have to seek gradually to replace the bilateral swap arrangents between the Federal Reserve Bank and the main European banks by a swap agreement tween the former and the EMCF which could both dampen the volatility of the dollar respect of the ECU and stabilize rates within the EMS as the currency used by e Federal Reserve Bank to repay the EMCF would not necessarily be the same as the rrency borrowed for the purpose of intervention.

The heavy fluctuations in the dollar and the resulting capital flows are threateng the cohesion of the EMS, thus justifying the central banks in reaching a common sition towards the dollar by seeking a probability zone for the ECU/dollar rate. zone of this kind would give the central banks a guide for action on interest tes and deciding on intervention.

. Under the present system, the EMCF has no hand in managing the EMS' external serves, the latter being deposited impermanently under the swap agreements which n be unwound at two working days' notice.

We propose that these swap agreements be consolidated and the dollar transfers de permanent so that the EMCF could use them freely. This responsibility, which uld be conferred on it at a later stage, would give the EMCF responsibility for suing ECUs. Initially these ECUs could be created against contributions of dollars, SDRs, national currencies or other reserve assets.

Subsequently they could be created against credits. Pursuit of these efforts would give the ECU greater permanence and would encourage its wider use. By managing its reserves, the EMCF would be able to intervene on the exchange rate market to control the rate of the ECU against the yen and the dollar or other non-Community currencies.

At this point it would also be logical for debts and claims between the central banks in the system to be denominated and settled in ECU alone.

Finally, if the EMCF manages its own reserves this would be a first step towards a genuine sharing of exchange rate risks which itself is a vital precondition for the acceptance of coordinated policies for intervention on the exchange rate market, especially on the dollar market[1].

Obviously, if this responsibility for managing reserves and creating ECUs were given to the EMCF, our criticisms in the previous chapter regarding the creation, acceptability, exclusivity, convertibility and the negotiability of the ECU would largely become redundant.

4. - Opening the system

16. The present system is closed to all but the central banks of the Member States belonging to the EMS.

However, the Community is itself open to the outside world and especially to its immediate neighbours. For many of these smaller countries, the EEC is the market which takes most of their exports. As the Commission rightly says[2] :

> 'If the EMS were opened up to the central banks of certain third countries, by authorizing them to acquire and hold ECU, the Community could strengthen the system (by extending its geographical area and increasing the possibilities for mobilizing the ECU), and could protect it from international monetary instability (by channelling at least part of the tendencies of reserve diversification towards the ECU); at the same time it could help with the financing of an overall external payments deficit.'

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[1] R. Triffin : Seminar on European Monetary Integration, concluding remarks - Copenhagen 13 - 14 March 1981

[2] European Economy, No. 12, July 1982, p. 50

When we consider how heavily balance of trade considerations weigh on national policies for economic recovery and employment it is difficult to understand why the Europeans have not been quicker to seize the opportunity of having the ECU share the role played by the dollar.

Hence the importance of internationalizing the ECU.

7. One initial step would be to authorize approved third parties to acquire existing ECUs freely from the participating central banks.

The latter could then mobilize their ECUs against dollars to settle their debts in ECUs without affecting the total volume of ECUs in circulation.

8. A second stage would be to authorize the EMCF to create ECUs for approved third parties against contributions of reserve assets, initially in the form of swaps, then against the permanent deposit of reserve assets.

Taking a broader and longer term view, the EMCF could issue ECUs for third parties either against deposits of Community currencies or in the form of credits.

This would of course imply that the EMCF would have a power of authorization, i.e. to nominate approved third parties.

It would have to regulate the volume of issues according to the requirements of stability and the desired distribution of ECU between EMS participants and other holders. It would also have to control liquidity and deal with the problem of the return on the ECU which, along with its stability, will be its principle attraction.

CHAPTER V - Private use of the ECU

1. - The birth of the private ECU

1. The ECU made its appearance on the private market in the same way as the EMS, by the conversion of amounts owing in national currencies into amounts owing in ECU. An institution or an individual deposits a sum in a national currency with a bank and asks the bank, which agrees to do so, to convert the sum into ECU. The depositor may use this account to subscribe to ECU loans or to settle debts or to make transfers provided that the creditor or recipient of the transfer agrees.

2. As a currency, the private ECU does not differ from the official ECU. The basket of currencies is the same with the same weightings. They are however two separate instruments. The official ECU operates solely within the EMS under the rules described above. The private ECU has completely separate and different rules. Its use as between private operators is on a contractual basis which, with the passage of time and the gradual recognition of the ECU as a currency, will tend to lose its specific and individual character to merge gradually with the general agreements governing the foreign exchange market.[1]

3. It is now possible, so far as it is allowed by national regulations, to buy ECUs, to have them transferred to another bank, to hold them in an account, to use them to settle a commercial transaction or for the purchase of long-term stocks. It is also possible to hedge by using the ECU. ECUs may also be bought regardless of the use made of them.

2. - Take-off of the private ECU

4. In 1979 and 1980, relatively little use was made of the ECU on the private market principally by the EEC institutions and the EIB, which had deposits in ECU at certain private Luxembourg banks.

By mid-1980 the total current account of fixed ECU deposits was estimated at about 500 million towards mid-1980.

After 1980 the situation changed rapidly. The issue of ECU loans encouraged the establishment of current accounts. Today it is estimated that current account and fixed deposits amount to nearly 4,000 million ECU.

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[1] See Pierre GUIMBRETIERE in 'Revue du Marché Commun', August-September 1982

The granting of ECU loans has practically kept pace with the increase in deposits. At the same time a market between banks has developed in which over 100 banks are involved.

5. This quantitative growth has been encouraged by the lowering of the minimum amount required for opening fixed deposit accounts from 1 million to 10,000 ECU. Since October 1982 a private Luxembourg bank has allowed its customers to open savings accounts in ECU into which unlimited amounts may be paid.

At the same time, various lending instruments have been initiated, from current account and fixed term advances to rollover credit whether or not syndicated.

In February 1981 Lloyds Bank issued the first ECU deposit certificates. In April 1981 the first ECU debenture loan was floated. There were four others in the same year for a total amount of 190 million ECU. By the end of 1982 the total volume of issues exceeded 2,000 million ECU. The ECU thus became the fourth issuing currency after the dollar, the DM and the £ sterling, but ahead of the yen and the French franc.

6. ECU debentures have been placed mainly in Belgium and Italy, and gradually in the Netherlands too. A secondary market has rapidly joined the primary market. All ECU debentures are quoted on the Luxembourg bourse.

As well as debentures denominated in ECU there are debentures indexed on the ECU but subscribed to in national currency. This was true of the 67,000 million Belgian franc loan raised in June 1981 which, because of the tax benefits it offered, was most successful.

At the same time an exchange rate market in ECUs has developed, aided by the following three factors:

(a) the interbank market

7. Originally, buying or selling ECUs was a transaction carried out in nine currencies at the same time. To cover itself, a bank receiving an ECU deposit had to divide it up among nine accounts, one for each currency in proportion to the weighting of each currency in the ECU. Those currencies then had to be actually bought and invested. The rate of interest on deposits or loans was thus the weighted average of the interest rates on comparable deposits and loans in the currencies in the ECU basket.

This represented a great deal of trouble and cost.

In 1981 the banks opened current and deposit accounts between themselves in ECU and granted each other current account and fixed-term advances. ECU transactions could then be carried out without having to be broken down into nine simultaneous parallel transactions and the banks were automatically covered against exchange rate risks.

This essentially bilateral clearing system does not include all the banks and does not put them all on an equal footing. Work is in progress to set up a central clearing system to provide more effective and wider compensation, and we believe this should be encouraged, or the task conferred on an institution like the BIS.

(b) Contracts based on the 'open ECU' basket

8. As we have seen, the private ECU is no different from the official ECU as it is made up of the same currencies in the same way. What happens if, as provided for in the rules, the EEC decides to change the composition of the basket?

Initially, when the banks had accepted the first fixed deposits in ECU, they did so on the basis of the 'closed basket', i.e. even if the composition of the ECU changed after deposit, redemption would be on the basis of the ECU rate towards the other currencies, still calculated according to the composition of the original basket. The same applied to short-term loans and interest rates. The 1981 Belgian loan for example was of this closed type.

But since then this closed basket clause has been gradually dropped and replaced by the 'open basket' clause, to the effect that the private ECU will automatically and immediately be adjusted to any change in the official ECU. If this were not done, there would be a great risk of several types of ECU appearing with different values, which would be likely to disrupt the private ECU market.

(c) Recognition of the official currency status of the ECU

9. Originally the ECU was no more than the sum of the currencies making it up, but in the eyes of the national authorities it consisted of two parts, the greater comprising other countries' currencies whose acquisition, disposal and conversion were subject to national exchange rate regulations, and the other,

smaller, part of their own national currency, subject to national rules. This was inconvenient, if not impossible.

Italy was the first country to accord the ECU foreign currency status, on 27 August 1981.

Belgium and Luxembourg followed in March 1982 and France on 21 May 1982. Denmark, the Netherlands, the United Kingdom and Ireland have not given official recognition, but the ECU is de facto treated as a foreign currency there. The Federal Republic of Germany is the one exception, where not only is the ECU still divided between foreign and national currencies, but any contract in ECU is prohibited by law.

3. Advantages of the ECU

10. These three factors, the interbank market, the open basket clause and foreign currency status have encouraged the spectacular rise in the private use of the ECU.

But the main explanation for this surprising phenomenon is the ECU's stability. As a basket of currencies it evens out fluctuations in the exchange rates and interest rates for the currencies making it up. For undertakings buying or selling in several Community countries, which thereby become creditors or debtors in various EEC currencies, the exchange rate risks are substantially reduced if they may denominate these credits and debits in ECUs. The same advantages apply in the money markets where investments or loans in foreign currencies are involved.

To give some idea of these advantages, we reproduce below a table comparing the cost of a six-month debt in ECUs with a similar debt in different currencies calculated on the basis of actual rates in force for a period between October 1979 and April 1983.

ACTUAL COST OF A 6-MONTH DEBT — Debtor country
- on an annual basis
- arithmetical average

urrency of debt	U.S.A.	GERMANY	JAPAN	SWITZERLAND	UK	FRANCE	ITALY	BELGIUM	DENMARK
[illegible]	14.39	23.61	18.09	21.83	25.47	30.61	31.81	30.37	30.14
M	2.02	9.27	5.13	7.66	11.78	15.96	17.13	15.74	15.64
EN	6.63	15.15	8.12	13.12	16.57	21.55	22.80	21.30	21.02
.F.R.	1.14	8.40	3.88	6.22	11.01	14.96	16.20	14.74	14.53
.K.L.	5.30	13.48	8.17	11.97	14.26	19.87	21.15	19.77	19.74
.F.	2.09	9.37	4.93	7.67	11.61	15.78	17.04	15.63	15.60
CU	2.60	10.08	5.58	8.41	12.15	16.58	17.80	16.38	16.33

Not only are exchange rate risks and costs generally less with the ECU, they are more fairly divided between the contracting parties than in the case of a third currency where the risks are borne either by one side or the other.

In cases like this, invoicing in ECUs offers the advantage of putting financial relations between the parties on a neutral basis, while at present the exporter usually imposes the choice of his national currency or the dollar. As the banks are offering a wide range of services in ECUs to their customers, industry and commerce will now be able to make use of them. But, unlike the financial world, in this sector development has been slower.

4. Meeting a genuine need

11. At all events, the rapid increase in the use of the private ECU has proved that it meets a geuine need. As the national economies merge and intra-Community transactions flourish, growing use of a European currency is logical and healthy.

The markets are spontaneously moving in that direction. The national monetary authorities should not oppose the trend. It is in their interest to encourage it, and even to regulate it to keep it within the constraints of monetary stability and interests of the economy in general.

12. Parliament should therefore unreservedly support the Commission's proposals for the use of the ECU which may be summed up as follows:

(a) Recognition of the status of the ECU

All Member States should recognize the currency status of the ECU and regard transactions denominated in it in the same way as convertible currency operations. The official quotation of the ECU on all the Community's exchange markets would be the culmination of such recognition.

(b) Use of the ECU

Community residents should be able to undertake transactions in bonds denominated in ECU under conditions of the general law: in certain Member States this implies derogations from existing regulations.

- Residents of the Member States should be able freely to subscribe at the official exchange rate to ECU loans issued within the Community and at all events to loans floated by the Community institutions.
- Subject to the regulations governing the composition of institutional investors' portfolios, ECU bonds would be treated in the same way as national bonds of a similar nature subject to any provisions to limit exchange rate risks.

(c) ECU trade mark

Although so far the private banks are following the procedures adopted by the Community authorities for defining the composition of the ECU and its value, the EMCF should issue a general set of regulations and ensure their enforcement to prevent divergent practices which could harm the development of the ECU.

Parliament should go further and propose

(a) that the Commission put forward specific proposals on the organization of a system of multilateral compensation for inter-bank transfers in ECUs, and on the introduction of the official quotation of the ECU on all the exchange markets of the EEC;
(b) that the Member States issue and circulate metal 1 ECU coins to popularize their use and to make Europeans more aware that they live in a European monetary area;
(c) that the Commission immediately organize a competition with a prize of 10,000 ECU for the best design of a symbol representing the ECU.

CHAPTER VI - The cases of Germany and the United Kingdom

1. It is common knowledge that the main but not the sole opposition to strengthening of the EMS and the private use of the ECU comes from Germany, while the United Kingdom, if not regularly objecting, has still not decided to join the EMS.

These two problems therefore deserve closer examination.

Section I - Germany

2. Germany, more than any other country in the Community, suffered the ravages of hyperinflation in the Thirties and immediately after the war. It is therefore only to be expected that her political leaders and monetary authorities have set action against inflation as the first priority of their entire economic policy. No sacrifice is too great here, and the discipline accompanying this policy has been accepted all the more readily as it has in general resulted in an economic performance for the most part better than that of Community countries applying other policies based on other priorities.

Things have changed slightly in recent years and European economic integration has progressed so far that despite its discipline Germany has been unable to escape the general crisis affecting Europe. Nevertheless, the ghost of inflation still haunts Germany, and explains why the Bundesbank's attitude towards European monetary integration finds such ready and unconditional support among politicians and in all parties, whether of the right, left or centre.

3. Relations between Germany and the EMS also, and perhaps primarily, hinge on the Bundesbank.

Its substantial power under the statutes imposed on it by the Allies giving it great independence of any other power, including the political arm, has ensured that strengthening the EMS without the consent of the Bundesbank is unthinkable. Chancellor Schmidt's full weight had to be thrown into the balance to establish the EMS, and it soon became apparent that the Bundesbank's agreement had been given only reluctantly after carefully deployed ambiguities which soon burst asunder in the debate on the future development of the system.

4. The Bundesbank's opposition to the Commission's proposals for improvements was clearly set out in its annual report for 1981.

It may be summarized as follows:

By taking the course proposed by the Commission, the strong currency central banks could be obliged to lend their currencies to weak currency central banks to a greater extent than at present and thus perhaps to increase their money supplies more than they think fit for their domestic needs; whch is no way to fight inflation.

Moreover, the credits used for these interventions are at present repayable up to 50% in ECU, but this figure could be raised to 100%. The strong currency central banks are therefore afraid that they might be forced to accumulate ECU reserves with the attendant exchange rate risks beyond what they regard as acceptable limits.

5. Of course these objections would fall away if there were no longer weak and strong currencies, in other words if there were a high degree of convergence of the European economies.

Although it sometimes complains about the DM's special role as a reserve asset and international investment currency, the Bundesbank feels that it imposes duties and obligations which would be hard to reconcile with those it would have to assume if the ECU were also to play that role. In other words there is no room for many currencies acting as reserve assets or international payment instruments. It would be either the DM or the ECU, but not both.

It is easy to see the Bundesbank's difficulty in making a choice, and, as we shall see, this also applies to the Bank of England.

6. Regarding the more specific proposals for strengthening the EMS in respect of acceptability, convertibility and the issuing of ECUs, the Bundesbank has raised objections of a technical nature which would take too long to discuss in this report.

Let us concentrate on its fear of seeing the development of the ECU encourage the uncontrolled growth of international liquidity.

7. What can be said in reply to the Bundesbank's objections?

(a) If we had to wait until there was sufficient convergence to remove all tensions between the EMS currencies before seeking to improve it, there would be no further need for the EMS.

For if there were no longer any differences in inflation rates, there would be no problem in maintaining exchange rates. All that would be needed would be to control the problem of speculative capital movements. This was the situation before the Bretton Woods system collapsed.

(b) Whether we like it or not, the European economies have now reached a stage of integration where no country can expect to return to a state of stability and prosperity in the midst of inflation, recession and unemployment. Rather than playing the monetary isolationist card, which in the end leads nowhere, why not attempt to instil more discipline in the weakest in exchange for rather more solidarity from the strongest? Everyone would benefit.

(c) World economic expansion requires an international monetary order. Bretton Woods cnanot be recreated.

One might hope to re-establish a number of large monetary stability zones (dollar/yen/ECU) between which one would attempt to keep fluctuations in check, with the hope of one day stabilizing them within a strengthened IMF.

Europe, of all the economic zones the most open to the outside world, needs monetary stability as a defence.

(d) Neither the DM nor the pound sterling can ever become a reserve currency comparable with the dollar, even on a smaller scale. Should the EMS collapse, the DM could probably group half-a-dozen neighbouring currencies around it, but a monetary area of this kind would offer far less advantages than a zone like the ECU zone could if strengthened.

(e) The uncontrolled growth of international liquidity is indeed a cause for concern. But the phenomenon exists today and the ECU has nothing to do with it.
What can the Bundesbank do against the proliferation of Euro-currencies and what has it done?
If the ECU became a genuine payment instrument and reserve currency, it would be a substitute for Euro-currencies with the advantage of even being under control as the EMCF policy would still determine its creation.

(f) The last two realignments of rates within the EMS have shown that discipline could play a part and encourage convergence. Efforts to achieve convergence and strengthen the EMS could be pursued simultaneously, the one strengthening the other.

(g) The effects of the succession of revaluations of the DM which have made it the strongest currency in the EMS have been alleviated by the establishment of monetary compensatory amounts in the agricultural sector, which amount to a subsidy to German agriculture paid by the EEC as a whole. Without the EMS and without the monetary compensatory amounts, the constant revaluation of the Mark would have ruined a considerable section of German agriculture.

Section II - The United Kingdom

8. The United Kingdom played a prominent and even constructive part in the negotiations paving the way for the EMS. It signed the agreements establishing the intervention mechanism. The pound is part of the basket for the ECU, the Bank of England has deposited and kept 20% of its gold and dollar reserves with the EMCF and the UK Government plays a full part in decisions on the alignment of the central rates. However the pound sterling is not part of the exchange rate mechanism.

Why?

9. The United Kingdom has four objections.

(a) Belonging to a fixed exchange rate system would limit monetary policy options. The defence of exchange rates might conflict with the aims of monetary policy and economic policy in general, such as employment and expansion.

The compulsory buying or selling of foreign currency reserves to preserve exchange rates leads to the destruction or creation of monetary signs, exactly the opposite course of action to that required to stimulate or restrain economic activity.

(b) The second objection is that belonging to the EMS could jeopardize the City of London's unique role on the international money markets and the position of sterling with its still very close links to the dollar.

(c) The fact that the pound is also a reserve currency and even a petro-currency brings constant variations in its value related not to domestic economic circumstances but to movements of capital or changes in the price of oil. In view of their size, the Bank of England would be unable to guarantee fluctuation margins for sterling narrow enough for the disciplinary needs of the EMS.

(d) The fourth objection is based on the idea that the United Kingdom is an economic power with ramifications throughout the world and a commercial and financial structure still governed by its role as centre of the Commonwealth. From this point of view the United Kingdom does not have the same interest as the other continental countries in becoming part of a purely European monetary union.

10. What can we say in reply to these objections?

(a) Any incompatibility between the aims of exchange rate stability and monetary policy is non-existent during a campaign against inflation. The problem could arise in the event of economic recovery by one or more countries, if supported by monetary stimulation. Experiments along these lines in recent years have shown the limits and ineffectiveness of such policies. It is unlikely that they will be repeated on a large scale in the near future.

If they were, the EMS has proved its flexibility and ability to absorb large inflation rate differences. The various realignments of central rates have been carried out in an orderly fashion without major disruption either of the system or of financial or trading patterns.

The United Kingdom had to give up the concept of flexibile exchange rates because of 'overshooting' and has increasingly embarked on a course of 'exchange rate targets' with all that implies by way of constraints on monetary policies.

Once this discipline is accepted, the credibility of the stability policy would be strengthened by British entry into the EMS, as the aim of the latter is to encourage monetary stability.

(b) It is not clear how belonging to the EMS could harm the City's role. Quite the reverse is true.

European financial integration will encourage the expansion of services on the Continent - insurance, brokerage and finance - which the London market can supply and in which it enjoys a degree of leadership. The use of the ECU to decompartmentalize the capital markets will benefit those who are equipped to offer the best services. In return, the United Kingdom's entry into the EMS would greatly encourage the use of the ECU and promote its stability.

What is to be feared is quite the reverse, that the City's role will finally wither away if the British economy weakens still further and if domestic policy objectives were to conflict with the operating requirements of an economy wide open to international competition.

(c) If the Bank of England feels unable to restrict the fluctuations of sterling within the narrow EMS margins, why not allow it to intervene within wider margins, as with the Italian lira? It would always be possible to reduce the margins later if experience showed this to be possible.

(d) It is historically true that the United Kingdom economy used to be oriented towards the Commonwealth and overseas, but things are changing fast. In 1958 the EEC took 20% of UK exports. In 1982 the figure had risen to over 45%, very close to the 55% average of its European partners.

The benefits it will draw from joining a zone of monetary stability which will soon cover half its foreign trade will be no different from those enjoyed by the other EMS members.

(e) If the pound enters the EMS this will help the European central banks to coordinate their policy towards the dollar, in view of the special links that have always existed between these two currencies.

It will also offer a European alternative to the DM for those holders of reserve assets who wish to get out of dollars, which would alleviate the tension between the DM and the other European currencies.

11. Quite apart from the reasons favouring sterling entry into the EMS there is the question of timing.

When the EMS was set up many observers felt that the pound was too weak to stand the discipline of fixed exchange rates and that these restrictions could have adverse effects on growth and employment in Britain. The pound rose from 1979 until 1981. Over this period voices were heard in London saying that the pound was too strong to join the EMS, which contained too many weak currencies. This was tantamount to saying that there would never be a right moment for entering the EMS. That was not what the House of Lords said in a recent report,[1] the concluding words of which were as follows:

> "The Committee believes that though exact timing must depend upon general government policy, the balance of advantage lies on early though not necessarily immediate entry".

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[1] House of Lords - Sitting 83-84 5th report 26 July 83 Select Committee on the European Communities. EMS

CONCLUSIONS

1. The EMS will soon have been working relatively well for five years. Its aim was not to recreate a system of fixed exchange rates, as its critics and too many journalists too often say, but to ensure the most stable possible relationships between the participating currencies. Controlled realignments are a feature of the normal operation of the EMS.

The results achieved should therefore be assessed in terms of this aim of stability rather than an immutable ideal.

Despite seven realignments in five years (which is too many), the variability of exchange rates as between participating currencies has always been less than that measured between each of the European currencies and the main currencies outside the system such as the dollar, sterling, the yen and the Swiss franc.

As about 50% of the foreign trade of the Ten takes place between Member States, this relative stability is important in cutting both the cost of exchange rate cover and losses. If this relative stability were taken away, operating costs in our economy would rise substantially.

2. There have been changes in rates but they have been controlled, i.e. the result of a joint decision, and not of unilateral action. The Community has thus avoided a succession of competitive devaluations which would have disrupted the Common Market, destroyed the basis of the common agricultural policy and aggravated the crisis.

3. The system has its weaknesses and inconsistencies. We have described them. There are remedies and we have described them too.

They are: strengthening the EMCF, acceptability and convertibility of the ECU, standardization of the way it is created, coordination of intervention policies towards third currencies, and above all the perfecting of new economic divergence indicators to trigger corrective action. The EMS must put internal and external stability on the same footing, not just in terms of objectives but of corrective mechanisms and instruments.

4. The rapidly expanding private use of the ECU is strengthening the European monetary identity and consolidating the EMS. This trend should be encouraged, as desirable in itself and because it meets a real need of all operators within the EEC who have to deal with exchange rate risks. The issue of an ECU coin would publicize the EMS and strengthen the political support required for its completion.

5. It would be in the interests both of the United Kingdom and of the proper operation of the system for the pound to join it as soon as possible. Events have shown British objections and fears to be exaggerated. The advantages to Europe and the UK exceed in size of the net UK contribution which is such a bone of contention today. The objection that sterling is a petrocurrency and inevitably volatile could be met by allowing special fluctuation margins (6%) such as apply to the Italian lira.

6. The establishment of a large European monetary stability area would mark a vital step towards the restoration of an international monetary order based on cooperation between the three major areas (dollar, yen, ECU) which would tend to reduce the frequency and size of exchange rate fluctuations between those three areas and would ensure better coordination of micro-economic regulatory policies by the concerted use of the most appropriate monetary and budgetary instruments.

7. It would be wrong to assume that because the EMS has survived seven realignments and five years of recession that it can permanently subsist in the face of all difficulties.

The events which allowed the system to survive might not be repeated. The system must therefore be strengthened as soon as possible, and we must exploit the coming year of respite to make the improvements we have put forward.

The technical objections of the central banks can be rebutted. In considering the more serious ones based on the lack of convergence of policies and performance, it must be borne in mind that thanks to the constraints imposed by the EMS and its support mechanisms, diverging policy trends have been reversed.

These constraints will be all the more effective when the EMS is regarded by all participating States as a vital and inexpensive instrument for external as well as internal monetary stabilization, from which they all benefit.

In other words, it is just as true to say 'The more EMS, the more convergence' as to say, as is more common 'No more EMS without more convergence'.

If the Council of Ministers has taken up the latter slogan, why should not Parliament adopt the former?

That is what we are asking it to do.

ANNEX I

MOTION FOR A RESOLUTION
DOCUMENT 1-425/83
tabled by Mr ISRAEL
pursuant to Rule 47 of the Rules of Procedure
on the creation of a European Savings Account
in ECU in all the Community countries

<u>The European Parliament,</u>

A. recalling its attachment to the European Monetary System,

B. anxious to make feasible a wider use of the ECU in the European Community,

C. having regard to the need to protect the savings of European citizens,

D. having regard to the need to safeguard savers from falls in the value and devaluations of their currencies,

1. Calls for the creation of a European Savings Account in ECU in all the Community countries;

2. Calls on the Commission to consider the procedures required for establishing a scheme of this kind, bearing in mind the Member States' prerogative in fiscal matters;

3. Instructs its President to forward this resolution to the Commission and the Council.

MOTION FOR A RESOLUTION

DOCUMENT 1-436/83

tabled by Mr SUTRA DE GERMA, Mr ROGALLA, Mrs THEOBALD-PAOLI, Mrs WEBER, Mr LINKOHR, Mrs VAN HEMELDONCK, Mr SABY, Mr ABENS, Mrs VAN DEN HEUVEL, Mrs DURY, Mr G. FUCHS, Mr LALUMIERE, Mr SEELER, Mr von der VRING, Mrs FUILLET, Mrs VIEHOFF, Mrs PERY, Mrs DESOUCHES, Mr EYRAUD, Mr SIEGLERSCHMIDT, Mr BOMBARD and Mrs VAYSSADE

pursuant to Rule 47 of the Rules of Procedure

on the institution of an international competition to devise a symbol representing the ECU

The European Parliament,

A. whereas the employment of a distinct sign, simple, easily recognizable and serving as a symbol, will encourage more sensible usage and enable European citizens to acquaint themselves with the ECU, of which they hear, but have never seen,

B. whereas an official symbol, registered, recognized and legalized, will be the distinguishing mark to prevent all unlawful and fraudulent practices that might occur in certain international transactions in the absence of statutory safeguards for the ECU,

C. whereas we are living in the age of the image and visualization,

1. Calls for an international competition to be organized to devise a symbol representing the ECU;

2. Requests that this competition should comprise firstly the presentation of a handwritten sign drawn in a minimum number of strokes, and secondly that of a character for use in printing, typing or data processing, which must be included in the near future on typewriter keyboards and the various computer printers marketed in and outside the EEC;

3. Instructs its President to forward this resolution to the Commission and the Council.

ANNEX III

MOTION FOR A RESOLUTION
DOCUMENT 1-748/82
tabled by Mr PURVIS
pursuant to Rule 47 of the Rules of Procedure
on the ECU

The European Parliament,

Considering

A. the growing importance of the ECU in Community and world financial and monetary affairs,

B. the need to enhance the practical use of the ECU by clarifying certain matters of usage,

1. Resolves that

a. the conventional symbol[1] for the ECU should be placed before the E figure (e.g. E40),

b. the sub-unit of the ECU should be entitled 'cent', with 100 cents to 1 ECU,

c. the decimal point should be signified by a full-stop (E493.12),

d. commas may be used to signify thousands, millions and billions of ECUs (e.g. E12,000 and E12,000,000 and E12,000,000,000);

2. Asks its President to forward this resolution to the Commission and Council of Ministers urging execution of any necessary implementing steps.

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[1] The proposed symbol is an epsilon with the bar extending as far to the left as it does to the right.

MOTION FOR A RESOLUTION
DOCUMENT 1-1258/82
tabled by Mr ISRAEL
pursuant to Rule 47 of the Rules of Procedure
on the creation of a fungible European currency

The European Parliament,

A. Aware of the need to reinforce the European monetary system as the only European policy for protection against monetary disorder,

B. Aware of the fact that the expansion of the ECU is currently hindered by its too restricted and complex use which is unintelligible to the general public,

C. Having regard to the latent crisis of traditional methods of payment which is affecting international trade, in particular the banking system and the smooth running of enterprises,

1. Calls for the creation of a fungible European currency;

2. Recommends that all loans between the European central banks be denominated and settled in this new European currency;

3. Urges that the limit of acceptance of this currency between the central banks be pushed back to 100%;

4. Calls for the immediate expansion of the private use of this currency notably in the issue of bonds and certificates and through a system for inter-bank compensation;

5. Urges the abolition of all discrimination between this new currency and the other currencies;

6. Calls for the European currency, as a step towards its full recognition as an instrument of payment, to be used in electronic form through a network of 'point-of-sale' terminals available to card-holders;

7. Instructs its President to forward this resolution to the Commission and the Council.