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REPORT

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

on the European Monetary System

Rapporteur: Mr J. PURVIS

PE 74.894/fin.

English Edition

On 19 December 1980 a motion for a resolution on the European Monetary System (Doc. 1-761/80) tabled by Mr RUFFOLO and others was referred to the Committee on Economic and Monetary Affairs as the Committee responsible.

At its meeting of January 20-21 1981 the Committee on Economic and Monetary Affairs appointed Mr PURVIS as rapporteur.

The committee considered the draft report at its meetings of 24-25 November, 3-4 December 1981 and 26-27 January 1982 and adopted it at the latter meeting by 10 votes to 2 with 8 abstentions.

Participated in the vote:

Mr J. Moreau, (Chairman), Mr de Ferranti, (Vice-Chairman), Mr Deleau, (Vice-Chairman), Mr Purvis, (Rapporteur), Mr Beazley, Mr von Bismarck, Mr Bonaccini, Mr Carossino (deputizing for Mr Leonardi), Mrs Desouches, Mr I. Friedrich, Mr de Goede, Mr Hopper, Mr Marshall (deupitzing for Miss Forster), Mr Mihr, Mr Papantoniou, Mr Rogers, Mr van Rompuy, Mr Ruffolo, Sir Brandon Rhys Williams, Mr von Wogau.

C O N T E N T S

A.

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 European Monetary System

The European Parliament,

- noting the relatively stable relationship maintained between those currencies which are full members of the EMS exchange rate mechanism despite the adjustments made to it,
- noting, by contrast, the extreme volatility of sterling against these currencies,
- stressing the economic and industrial benefits of relative stability in exchange rates and the economic and industrial difficulties that can be caused by volatility in exchange rates,
- and convinced that the EEC economy as a whole outweighs in potential the sum of its national parts,
- but aware that the EMS, as presently constructed, is only a means to an end (i.e. Economic and Monetary Union) and is therefore in an inherently precarious state,
- and conscious that this precarious state will be accentuated by continuing divergencies in national inflation rates and economic policies, which prevent further steps being taken towards complete elimination of exchange rate variations,
- aware of the reluctance of the governments and monetary authorities of the Member States to relinquish even a part of their monetary sovereignty, for fear of losing control over their own economic situation,
- noting the Council of Ministers' failure to act and the Commission's lack of commitment as regards attaining the conditions for the transition to the second stage of the EMS provided for in the original agreements,
- having regard to the draft fifth medium term economic policy programme prepared by the Commission,[1]
- having regard to its resolution of October 1981 on the realignment of monetary parities,[2]
- having regard to the motion for a resolution (Doc. 1-761/80),
- having regard to the report of the Committee on Economic and Monetary Affairs (1-971/81);

[1] COM(81)344 fin.

[2] OJ C287

1. Reaffirms its complete commitment to the goal of European monetary and economic integration

   a) as being in the economic and political interests of the European Community, its industries and its people;

   b) as being a stabilising influence in the world economy;

   c) as providing thereby the potential of an alternative to the US dollar in world trade and investment flows;

   d) and potentially helping to alleviate the world recession caused by imbalances in the world's money flows since the 1973 oil price crisis.

2. Urges the setting up of a European Currency Authority, with a high level of autonomy, which will be charged:

   a) to issue and manage a European Currency Unit (ECU)

   b) to provide a means of settlement and store of value for international trade and investment;

   c) to maintain the stability and good name, credibility and credit-worthiness of the ECU in its own right;

   d) to foster the economic growth of Europe and will-being of its people;

   e) to sponsor the voluntary adoption of the ECU by governments, businesses and individuals, with the aim of it achieving ultimately legal tender status in all Member States.

But in the meantime,

3. Calls on all Member States to work towards the lifting of all restrictions on capital flows within the EEC by eliminating artificial exchange controls as soon as possible;

4. Considers that for the future development of European monetary integration all Member States must be full participants in the European Monetary System, and therefore:

   (a) Urges the United Kingdom to join the EMS exchange rate mechanism, in that the extreme volatility of sterling outside this mechanism is disruptive of that country's trade (46% of which trade is with other EEC countries) and of Community policies and interests (e.g. trade in industrial goods and services, agriculture, fishing, etc.);

   (b) Hopes Greece will join the EMS when the appropriate conditions prevail, and considers it essential that the Community facilitate Greece's entry by any means necessary including wider divergence margins at the outset, and special credit facilities;

   (c) Feels that present and future accession negotiations should include consideration of EMS membership on the appropriate considerations;

5. Urges all Member States to reaffirm their commitment towards coordinating their economic, fiscal and monetary policies with the agreed aims of

a) eliminating inflation;

b) providing the base for genuine economic growth;

c) and thereby affording the opportunity for more and better employment prospects,

and asserts that coordination of exchange rate policies (as required by the EMS) should be a major element in this field.

6. **Supports the Commission's call to the Member States, in its foreword to the draft fifth medium term economic policy proposals, for them to improve internal monetary cooperation, to employ the ECU more in their borrowing and lending activities, and to abolish any technical or statutory rules which stand in its way;**

Furthermore

7. **Stresses** the importance of Community regional and social policies to compensate the less advantaged geographical, economic and social sectors for the centralising effects of such a large unified economic bloc;

8. **Stresses** that the European Community's world responsibilities, especially in relation to the Third World, will be increases by successful integration of its economic and monetary policies, and that these responibilities must be shouldered whole-heartedly;

Therefore calls upon the Commission to:

9. **Present** to the Parliament and Council an annual review (separated from the annual economic review) of Community monetary and currency developments with particular regard to the EMS, the developing role of the ECU and progress towards European Monetary integration, incorporating proposals for Community action;

10. Present within 12 months a detailed proposal for setting up a European Currency Authority and establishing the ECU as a Community currency in its own right; **with particular regard to its degree of autonomy and political control, the appointment and role of its directors, and its capital structure;**

11. **Develop** proposals for a concerted Community response to:

a) the effects of US and other foreign monetary policies whereby the Community acts as one in achieving a mutually beneficial accord between the world's most important economic units in the area of monetary and exchange rate policy;

b) the problem of recycling world liquidity to the mutual benefit of the oil states, the industrialised countries and the less developed countries.

12. Open discussions with the British and Greek governments on the appropriate terms and conditions for their full participation in the EMS at the earliest possible moment, and to do the same with Spain and Portugal in the normal process of the accession negotiations;

13. Prepare a programme for the progressive and complete withdrawal of all exchange controls within the EEC;

And calls upon the Council of Ministers to:

14. Declare in formal terms its commitment to European Monetary Integration and thereby provide a new and strengthened political will to the construction of the European Community;

15. Asks its President to forward this resolution to the Commission, the Council of Ministers and Member State Governments.

B

EXPLANATORY STATEMENT

I. Introduction

1. This report, and the motion it supports, will not repeat the content of previous reports on the subject in all their technical detail. It should be considered as a development of these previous reports and the reader should certaily refer to them. The Economic and Monetary Affairs Committee Report of 1980 is particularly valuable and it can be taken as essential reading on the subject[1]. In a separate working document[2] there will be found a list of these precedents, and other literature on the subject, which can provide useful reference. The Commission's draft 5th medium term economic policy programme (COM (81) 344 final) also contains some important reflections on the subject in point 4 of the Foreword.

2. Your rapporteur is convinced that the future of European Monetary Union and of the EMS in particular is much more a political matter than a technical one. Given the political will to make progress, the technical problems will be readily solved. How do we elicit that political will on the part, especially, of Member State Governments?

II. a) The case for currency stability

3. It is quite evident that volatility in exchange rates is a major impediment to commercial intercourse between the countries or currency blocs concerned.

Your rapporteur has been assailed in his constituency work by interests as diverse as fishermen, farmers, exporters, importers, small and large industries, on the theme that the volatility and unpredictability of exchange rates make it very difficult a) to do business across currency frontiers and b) to plan investment. A sudden strengthening of their currency can suck in imports and make contracts quoted in other currencies unprofitable when settlement is finally made. A sudden weakening can upset costings where imported raw materials or components are concerned.

4. The problem is no less acute for governments and central banks who are trying to balance their priorities of fighting inflation and unemployment when their chosen balance is disrupted by the effects of extreme currency fluctuations and related factors, such as interest rates.

5. It is clear that movements in exchange rates can not be ignored completely in pursuing domestically either expansionary or contractionary economic policy. This does not preclude the need for exchange rate adjustments such as are required to adjust for fundamental divergences in economic policies and performances. But certainly one can expect the extreme fluctuations to be smoothed as they serve no useful purpose in either commercial or economic terms and can in fact deny economic managers the rewards of the policies they are pursuing.

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1 Report on the EMS as an aspect of the international monetary system Doc. 1-63/80 Rapporteur: Mr G. Ruffolo

2 PE 74.894/Ann.

b) Speculation

6. The extremes of such fluctuations are due to speculative pressures of a classical and self-fulfilling nature. Speculation is an essential factor in any market place. But market psychology holds that a trend is bound to continue and therefore it is magnified (in the absence of any restraint) until the reverse trend is set in motion. This trend in its turn becomes magnified as it becomes commonly accepted as never ending.

c) Restraint and Smoothing

7. The speculator is less liable to take risks where he can identify the existence of some constraining force. The EMS is such a force, as was the Bretton Woods system in a broader arena. But experience with both systems demonstrates that they are no protection(indeed they can be weak dams before a deluge) when expected to stand against fundamental disequilibria. Their role is circumscribed but none the less useful in avoiding the short term extremes of volatility that can be experienced in a completely unrestrained and free floating regime.

d) Experience with EMS

8. Appendices III-XIII of the working document[1] contain graphs and statistics which amply demonstrate the contrasting relative stability between those currencies participating fully in the EMS exchange rate mechanism and the £ sterling, US dollar and Japanese yen. Even taking into account the occasional need for a realignment of EMS parities, it is evident that the trader operating within this lake of relative currency stability is better placed than those operating in and out of it. At the very least the costs of forward exchange cover will be reduced because of less risk and therefore tighter spreads. And although there is a restraint on the freedom of action of their economic managers this is certainly as great, arguably greater, for those managing the free floating currency economies. For example the recent extreme downward fluctuation of the £ Sterling against the US dollar, and then EMS currencies, has forced an unwelcome increase in interest rates in order to prevent an even greater downward slide in the exchange rate and the inflationary impact this would have on the UK economy.

e) Conclusion

9. Your rapporteur is therefore convinced that

i) extreme exchange rate volatility is bad for trade, industrial efficiency, economic growth and the fight against inflation and unemployment, especially in the case of an economy heavily dependent on external trade;

[1] PE 74.894/Ann.

ii) such volatility will also impede the growth of international trade in general and therefore could instigate a trend to protectionism and world-wide recession;

iii) it will discourage the useful longer term investment of world liquidity (especially the extremely large balances in the hands of the oil producing states) and encourage their short term transfer from one financial centre to another - thus further disrupting the world monetary and economic scene;

iv) greater relative stability and the commitments such agreements imply, will not necessarily impede economic management any more than the opposite will;

v) even if the era of free floating rates has permitted major readjustments of economic policy to take place in certain countries where they were badly needed, there comes a time when a return to greater stability and exchange rate discipline must be made in order to ensure the success of these adjustments;

vi) the UK should join the exchange rate mechanism of the EMS forthwith. Not only would this be beneficial to the UK, its fishermen, farmers and businessmen, but also to the countries already participating because sterling's volatility is a factor in the ECU to which their currencies are tied;

vii) as a matter of course, accession agreements for new Member States should provide means to facilitate their entry into the EMS and Greece's interests should be of particular concern at the moment;

viii) it is vital to reach some form of agreement with the USA and Japan which will help towards the reduction of the extremes in currency volatility between these three major elements in the world economy;

ix) there must be a strong political reaffirmation by the Member States of the EEC in the ultimate goal of European monetary and economic integration;

III. a) The future

10. The EMS, as currently constructed, is only a half-way, or perhaps quarter-way, house. It is like standing on a wobbly stepping-stone in the middle of a fast-flowing stream. If the forward momentum is not maintained, there is a risk that one will be toppled into the water.

11. The original plan was that the margins of fluctuation could be gradually reduced as the Community's economies converged in objectives, management and performance. In the end a system of tied currencies could be reached - one short step from a single currency. However the further postponement of Stage II bodes ill for the future of this route.

12. Your rapporteur is doubtful if this course is potentially practicable within any reasonable time scale - above all because of the evident

divergence in economic ideologies which exist in Europe and the tendency towards emotional, if unreasoning, attachment to the trappings of independent nationhood - such as national currencies represent.

b) The ECU

13. There would seem to be a major role for the ECU in breaking out of this impasse so that the benefits of a single currency bloc can be gained while getting round the emotional antagonism that compulsion could engender.

14. It would be preferable to offer the facilities of the ECU as a European currency with a stability guarantee[1] to be taken up voluntarily by those who see it as useful to their purposes. If properly and responsibly managed, it is likely that central banks (not only in the EEC), international traders (not only in the EEC), businesses, tourists and thus the population at large, will avail themselves of it as a means of exchange settlement and store of value. The only formal legislative step required of member governments at an appropriate moment, would be to make the ECU legal tender in their countries alongside the national currency and to eliminate intra-EEC exchange controls.

To achieve this end, we call on the Commission to bring forward proposals to set up the ECU as a currency in its own right and under the control of an independently chartered European Currency Authority (see point 2 of Motion for a Resolution).

c) Regional and Social imbalances

15. We accept that a unified economic and monetary bloc on the scale of the EEC will present problems of regional and social disparities. It is therefore vital that any move towards greater monetary integration should be coupled with regional and social policies that can recirculate resources within the Community and promote convergence of living standards at a high level. The role of the Community budget is central to this activity. Its scope must be adequate and its balance adjusted to achieve essential policy aims, as well as to promote economic growth of the Community as a whole.

Parallel with the budget itself, the European Investment Bank and a European Monetary Fund would have important roles in fueling genuine economic growth and counteracting monetary imbalances.

d) Reporting

16. The monetary system is so central to future construction of the European Community that it would be beneficial if the Commission could undertake to make a regular annual report to Parliament and Council on monetary and currency developments and the progress towards monetary integration, with particular regard to the EMS and ECU.

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[1] The idea of an indexed currency is explored in the so-called All Saints Day Manifesto, see Bibliography in Working Document PE 74.894/Ann.

17. This would provide an opportunity for monitoring progress, instilling political considerations and exerting democrative control by the two bodies which directly and indirectly represent the wishes and aspirations of the people of Europe.

IV. The Essentials

18. The European Community would never have started without political will and foresight. Its continuation and development depends on political will and foresight. This is no different in the monetary field. In fact its critical importance to the future of Europe requires especial concentration of political will.

19. Your rapporteur presents this Motion for a Resolution in the hope it will broach some taboos, touch some responsive chords and help towards a European Community which can be seen by all its people to be finding answers to the major political, economic and social difficulties of the 1980s and beyond.

MOTION FOR A RESOLUTION (Doc. 1-761/80)

tabled by Mr RUFFOLO, Mr ZAGARI, Mr COLLA, Mr DIDO, Mr LEZZI, Mr PILIKAN, Mr ORLANDI, Mr SIEGLERSCHMIDT, Mr VERNIMMEN, Mr Bruno FRIEDRICH, Mr HÄNSCH Mr ARNDT, Mrs WEBER, Mr RIEGER, Mr ARFE, Mr GLINNE, Mrs FOCKE, Mr KÜHN, Mr DANKERT, Mr LANGE, Mr GABERT, Mr von der VRING, Mr VAN MINNEN and Mr COHEN

pursuant to Rule 25 of the Rules of Procedure

on the European Moneatry System

The European Parliament,

- having regard to the deliberations of the European Council at its last meeting on 1/2 December 1980,

1. Expresses its profound and complete dissatisfaction at the decision to defer the transition to the second stage of the European Monetary System;

2. Points out that the reasons invoked to justify this decision, which was taken after the European Council had twice solemnly confirmed and reaffirmed its commitment, can only be regarded as an attempt to justify the Council's utter failure as regards the objectives set when the EMS was established;

3. Notes that no practical measures have been taken to bring about the process of gradual convergence of the Member States' economies which was supposed to accompany and facilitate the transition to a phase of more advanced monetary integration, which in turn would have given this process an additional boost, chiefly through the setting-up of the European Monetary Fund;

4. Reiterates the view it expressed on a previous occasion in its resolution of 16/17.4.80 on the precarious nature of the EMS in its present stage, in which it remains vulnerable to strong external pressures owing to the absence of a common policy towards the dollar, and to strong internal pressures resulting from insufficient coordination of economic policies and the lack of a substantial Community monetary reserve enabling the consequences thereof to be attenuated;

5. Considers that in these circumstances the prolongation of this precarious phase of the EMS is likely to accentuate the system's basic weakness, namely that it imposes on Member States obligations which, owing to the asymmetrical nature of the system, place a particularly heavy burden on the economically weak countries, instead of pursuing the objectives and policies necessary to ensure the convergent development of the Community's economies;

6. Requests the Commission to submit to the European Parliament as soon as possible a report on the reasons for and implications of the European Council's decision.