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ORGANISATION DES RELATIONS MONETAIRES ET FINANCIERES AU SEIN DE LA COMMUNAUTE

(Communication de la Commission au Conseil
et projet de Résolution du Conseil)

MEMORANDUM ON THE ORGANIZATION OF MONETARY AND FINANCIAL RELATIONS WITHIN THE COMMUNITY

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Memorandum from the Commission to the Council on the organization of monetary and financial relations within the Community (12 January 1972)

As it had expressed the intention of doing at the meeting of 21 December 1971, following the Conference of the Group of Ten in Washington, the Commission adopted and immediately sent to the Council, on 12 January 1972, a memorandum and a draft resolution on the organization of monetary and financial relations within the Community, with due regard for the Washington decision. The full text of this document is given below:

1. The decisions taken by the Ministers of the member countries of the Group of Ten on 18 December 1971 comprise:

(i) The fixing of new exchange rate relations in the form of parities or "central" rates

(ii) Provisional widening of the fluctuation margins of exchange rates to more or less 2.25 % on either side of the new rates.

These decisions made possible the establishment between the member countries of the Community of exchange rates relationships which are better balanced than those resulting from the diversity of the systems functioning since 10 May 1971.

The abolition of the surcharge and the discriminatory measures introduced or envisaged by the United States Government on 15 August 1971 completes the differentiated realignment of currencies.

The Washington Agreements thus put an end to the insecurity and uncertainty which, in the course of the month ahead, could well have seriously affected the rhythm of economic activity, employment and trade in the Western world. However, they do not constitute any complete settlement of the international monetary crisis.

The resultant situation poses three main problems for the functioning of the Community:

(i) In the first place, the widening of the fluctuation margins now authorized at international level would cause considerable difficulties if it were applied to intra-Community exchange relationships. Should the Community countries adopt fluctuation margins of 2.25 %, more or less, with respect to all currencies, including those of their partners in the Community, the variation of the exchange relationships between two Community currencies could be as much as 9 % if the interventions of the Central Banks on the exchange market continued to be effected using the dollar. Such a situation would consecrate the central role of the dollar in intra-Community monetary relations. Furthermore, it would affect the conditions of competition in trade in industrial products and services, would disorganize the agricultural common market and would be an obstacle to the convergence of economic policies which call for the balanced functioning of the Community and the gradual achievement of an economic and monetary union.

(ii) In the second place, nothing was done in Washington to ensure a return to dollar convertibility. The problem is simply placed on the agenda of later negotiations. If no change were to be introduced into the procedures by which the Central Banks intervene on the exchange markets, they would be obliged to use an inconvertible currency for these operations: the dollar. They could then find themselves led to pile up dollar assets without any guarantee of being able to transform them into reserve instruments or other currencies.

(iii) Finally, although the adoption of realistic exchange rates and the widening of the margins of fluctuation can help to normalize capital movements, no arrangement has been made to regulate the international capital market. It may normally be expected that monetary realignments will provoke a flow of capital back to the United States during the coming months. However, the possibility is not to be excluded that in future speculative movements will again exert heavy pressure on certain European currencies and trigger off in the Community disturbances similar to those which have occurred in the course of recent years.

In order to cope with these problems the Community, in conformity with the programme for economic and monetary union which it has put in hand, must strengthen and efficiently organize monetary cooperation between its members, with whose action the applicant countries and—if they so desire—other European countries could associate themselves.

In the opinion of the Commission it would be important that the Community should be able on the one hand to establish as soon as possible, and taking into account the studies in the Committee of Governors of the Central Banks and the Monetary Committee an exchange system proper to the currencies of the Member States and on the other hand provide itself with the means to apply a concerted policy with respect to excessive inflows of capital.

2. The exchange system proper to the currencies of the Member States of the Community could, in conformity with the indications contained in the Report of the Committee of Governors dated 1 August 1970, present the following features:

i) The margins of fluctuation of exchange rates between the currencies of these countries would be narrower than those at present authorized at international level;

ii) Coordinated intervention using Community currencies as well as dollars would be practised by the Central Bank on the exchange markets;

iii) A Monetary Cooperation Fund would be set up with the task of regularizing exchange operations and using a European unit of account for this purpose.

A. Narrowing of the fluctuation margins allowed between Community currencies

In the conclusions to its studies of 8 and 9 June 1970, and then in its resolution of 22 March 1971, the Council agreed that the Community should not take advantage in exchange relations between its member countries of any provisions allowing for greater flexibility of the international exchange system.

In conformity with these decisions, the normalization of intra-Community exchange relations must include the restoration, as between the currencies of the member countries, of the fluctuation margins in force before 9 May 1971, that is to say 0.75 % on either side of the parities. This means that the immediate gap between the highest and the lowest rates of these currencies may not exceed 1.5 %. Return to this situation is an objective which should be achieved as rapidly as possible.

If, in view of the profound disturbances which have affected exchange markets in recent months, the Member States should nevertheless fear that immediate return to such margins would provoke certain strains, it would be possible to admit wider margins even between the Community currencies for a transitional period.

But it would be advisable in this case at least to watch that a discrimination whose volume would be considerably increased if the margins were widened was not maintained for the benefit of the dollar. In this respect, a neutral situation would be obtained if the maximum instantaneous gap between two Community currencies were fixed at 2.25 %. In order to make it clear that the Community was beginning to go its own way in monetary matters, it would neverthless be desirable to fix this maximum gap at 2 %.

In this way, while introducing a certain flexibility into intra-Community monetary relations, the drawbacks for the functioning of the Common Market, and particularly of the agricultural common market, of a widening of the margins, would be limited. In any case, a more ample widening would inevitably produce considerable distortion in intra-Community trade and in trade with third countries.

Whatever happens, the enlargement envisaged should only be applied on a temporary basis.

B. Coordinated action by the Central Banks on the exchange markets

With a view to maintaining the rates of European currencies vis-à-vis the dollar within limits of rougly 2.25 % on both sides of the central rates, and the rates of the European currencies among themselves within the limits laid down below, the Central Banks of the Community will have to engage in coordinated intervention on the exchange markets.

These Banks would have to be instructed to intervene using Community currencies in order to ensure observation of the limits of fluctuation between these. Interventions in dollars would be reserved in principle for those cases where the fluctuation limits vis-à-vis the outside world had been reached.

The Committee of Governors of the Central Banks would lay down the guidelines of the intervention policy to be followed on the basis of these principles.

In order to cope with the problems which would arise for certain Central Banks if they were not able, because of their Community obligations, completely to utilize the margins of fluctuation authorized on the international plane, the Committee of Governors could decide to shift the "Community band" according to an appropriate procedure.

The machinery of short-term monetary support and medium-term financial aid could be used, under the conditions laid down by the decisions which created them, to offset any possible drawbacks resulting from the width of the "Community band" and from the position of this band vis-à-vis the currencies of third countries which would be accepted by these in the common interest.

The Central Banks of the Community would be led under the new system of intervention on the exchange market to hold in their reserves Community currencies along with the various existing reserve instruments. This should, however, be subject to appropriate limits and conditions fixed in the light of harmonization of the reserve policies of the Central Banks.

C. European monetary Cooperation Fund

In order to facilitate coordination of the actions of the Central Banks on the exchange market and harmonization of their reserve policies, a European Monetary Cooperation Fund would be set up under the authority of the Committee of Governors of the Central Banks.

This Fund woud keep an account of the balances resulting from action on the exchange market and these balances would be entered to the credit or debit of the Member States concerned. The situation of the latter's accounts with the Fund would be settled under conditions to be agreed upon, particularly in liaison with the systems of short-term monetary support and medium-term financial aid.

The operations of the Fund would be expressed in a Community unit of account whose value would be 0.888671 gramme of fine gold. This unit would gradually be called upon to fulfill the functions of an instrument of intervention on the exchange markets.

In proposing the establishment of a European Monetary Cooperation Fund, the Commission is not unaware of the fact that action on the exchange markets could, in the initial stage, be carried out individually by each Central Bank in the setting of concerted Community action ensured by the Committee of Governors of the Central Banks.

However, recourse to the technique of a Fund would seem to present certain advantages, particularly in the current situation. This technique would make it possible to establish greater solidarity between Central Banks in the Community. It has the further advantage that it equalizes better the dollar position within the Community and avoids certain countries accumulating dollars while others are losing them; at the same time, the Community as a whole would be in balance vis-à-vis the United States. Finally, the introduction of a European unit of account for the operation of the Fund would be an initial evidence of the Community's monetary personality and could open the way to gradual utilization of this unit in Community financial transactions.

The Commission recalls that, in its resolution of 22 March 1971, the Council invited "the Monetary Committee and the Council of Governors of the Central Bank to draw up in close cooperation, and at the latest by 30 June 1972, a report on the organization, the functions and the statutes of a Monetary Cooperation Fund". The Commission hopes that this report will be completed by 30 April 1972, in such a way that the Council may reach a decision before the next Annual Meeting of the IMF.

3. In order to safeguard the stability of an exchange system proper to the Community and to forestall in particular disturbances which might result from sudden and massive short-term capital movements from abroad, it is important that the Member States should have available machinery whose use would make it possible to strengthen the effects of the widening of fluctuation margins vis-à-vis the outside world and to which they could have recourse without delay if the need arose.

On 23 June 1971 the Commission submitted to the Council "a proposal for a directive on the control of international financial flows and the neutralization of their undesirable effects on internal liquidity".

The measures advocated in this draft directive are:

(i) Regulation of investments on the money market and of the remuneration of deposits by non-residents;

(ii) Regulation of loans contracted abroad by residents;

(iii) Regulation of the net external position of the credit institutions;

(iv) Fixing of obligatory reserve coefficients, particularly for assets of non-residents.

So that the Community may not again find itself in the future in a position where it is unable to react in a concerted manner to speculative inflows of capital, it is important that the draft directive, which has been the subject of an Opinion of the Monetary Committee, should be very rapidly adopted by the Council.

It would be advisable also that the Monetary Committee should report to the Council and to the Commission by 1 June 1972 on the conditions for implementing this directive in the Member States and on the procedure which needs to be applied so that, in the event of an influx of capital into one or more Member States, consultations are immediately begun in the competent Community agencies to fix the details of concerted action by the Member States which would not impede the gradual creation of a European capital market.

4. The Commission wishes to stress that the strengthening of monetary solidarity within the Community must be accompanied by:

(i) Efficient coordination of medium- and short-term economic policies in conformity with what is laid down in the resolution 22 March 1971. This coordination will be necessary in particular in the field of interest rates and it will have to be strengthened as and when margins within the Community are progressively narrowed;

(ii) Measures to facilitate the movement of capital within the Community and to promote the formation of a European capital market;

(iii) The implementation of a regional policy aimed at reducing the existing disparities between the various regions of the Community and entailing the necessary transfers of resources to the less favoured regions. An initial step in this direction would be the application of the resolution of 22 March 1971, and particularly the adoption as a matter of urgency of the proposals made by the Commission in this respect;

(iv) The strenghtening of a social policy to promote employment, training and readaptation of workers in the member countries.

5. The Commission believes that the present circumstances offer the Community a special occasion to make important and concrete progress on the road to economic and monetary union.

It requests the Council to take as soon as possible, and on the basis of this memorandum, the decisions concerning the introduction of the Community's own exchange system and the adoption of a concerted Community policy with regard to excessive inflows of capital.

It hopes that it will be possible to establish contacts on this matter with the applicant countries and other European countries which might wish to associate themselves with the Community's actions.

The Commission is convinced that in this way it will be possible for the Community to constitute within the international monetary system, an area of free monetary convertibility and stability".

Draft of resolution of the Council and of the Representatives of the Governments of the Member States

The Council of the European Communities

and

The Representatives of the Governments of the Member States

considering the Memorandum of the Commission to the Council, dated 12 January 1972,

considering the draft of the Commission:

whereas, by the resolution of the Council and of the Representatives of the Governments of the Member States of 22 March 1971,[1] the Council agreed that the Community should not take advantage in exchange relations between Member States of any provisions which might allow a relaxing of the international exchange system and that the Community should adopt joint positions in monetary relations with third countries and international organizations;

whereas, by virtue of decision of the Governing Board of the International Monetary Fund No. 3463, dated 18 December 1971, it was laid down that the margins of fluctuation of exchange rates around central rates would be widened to ± 2.25 % in each direction, thus allowing of a maximum range of 9 % in the variations of exchange ratios between any two Community currencies;

whereas such a widening of the fluctuation margins, now authorized at international level, could not be applied to intra-Community exchange relations without affecting the conditions of competition in trade in industrial products and services and without disorganizing the functioning of the agricultural common market, and that it would moreover be an obstacle to the convergence of economic policies which the balanced functioning of the Community and the gradual achievement of an economic and monetary union require;

whereas, since it is necessary to return, in exchange relations between Member States, to rate fluctuation margins compatible with the requirements of the Common Market; and that the return to the margins in force before 9 May 1971 might well cause difficulties in the management of a Community fluctuation band which is relatively rather narrow in relation to the margin allowed under the decisions of the Board of Directors of the International

[1] *Journal officiel* C 28, 27 March 1971.

Monetary Fund above mentioned; and that it would be admissible to maintain on a temporary basis and without any unacceptable perturbation in intra-Community relations a margin of fluctuation such that the immediate maximum gap between the highest and the lowest rates of the currencies of the Member States would not exceed 2 %;

whereas it is advisable in these circumstances that the Central Banks of the Member States should coordinate their interventions on the exchange markets in order to ensure that this aim is achieved;

whereas these interventions will have to be made not only in dollars but also in Community currencies;

whereas the settlement of the balances of these operations between member countries would be facilitated if these balances were booked with a European Monetary Cooperation Fund under the authority of the Governors of the Central Banks, and whereas furthermore the creation of such a Fund offers the advantage of better equalization of dollar positions within the Community and avoidance of the situation in which certain countries accumulate dollars while others are losing them, whilst the Community as a whole would be in balance vis-à-vis the outside world;

whereas the events which have occurred at international level since the month of May 1971, and in particular the widening of margins admitted by virtue of the decision of the Governing Board of the IMF above mentioned, makes it imperative to expedite the establishment of this Fund whose creation was already mentioned in the final communiqué of the Conference of the Heads of States or Governments on 1 and 2 December 1969 in The Hague, and also by the resolution of the Council and of the Representatives of the Governments of the Member States of 22 March 1971 concerning the implementation by stages of economic and monetary union,

Adopt the following resolutions:

1. The Council and the Member States instruct the Central Banks to maintain the fluctuations of rates between currencies of the Member States within such limits that the immediate gap between the highest and lowest rates of these currencies cannot exceed 2 %.

2. To this end, the Central Banks will have to intervene in coordinated fashion on the exchange markets both in Community currencies and in dollars in order to ensure respect for the margins of fluctuation between these currencies laid down above.

3. The Central Banks, in the framework of the coordination provided for within the Committee of Governors of the Central Banks by the Council decision of 22 March 1971 (71/142/EEC),[1] shall decide;

a) On the detailed procedures by which the Community band could be moved within the margins of fluctuation authorized at international level;

b) The guidelines of the intervention policies to be followed and the procedures for holding in their reserves Community currencies along with the various reserve instruments, such holding being subject to appropriate limits and conditions, laid down with a view to harmonization of the reserve policies of the Central Banks.

4. The Council agrees that, on the basis of a report which the Committee of Governors of the Central Banks will submit to the Council and to the Commission on the functioning of the concerted action of the Central Banks on the exchange market, new measures will be decided as soon as possible for the gradual reduction of the margin of fluctuation provided for at point 1 above and also the transition from a *de facto* to a *de jure* system.

5. The Council instructs the Monetary Committee and the Committee of Governors of the Central Banks to establish before 30 April 1972 a report to the Council and the Commission concerning the organization the functions and the statutes of a European Monetary Cooperation Fund, in such a way that the Council may be able to reach a decision before the next Annual Meeting of the International Monetary Fund.

[1] *Journal officiel* L 73/14, 27 March 1971.