

No. 32/1978

December 8, 1978

EUROPEAN COUNCIL AGREES TO ESTABLISH EUROPEAN MONETARY SYSTEM

The European Council, the heads of state or government of the nine member states of the European Community, agreed at their meeting in Brussels on December 4 and 5 to establish a European Monetary System (EMS) on January 1, 1979.

The new system will have as its center a European Currency Unit (ECU), and will incorporate a compulsory intervention mechanism to ensure greater stability of European exchange rates. The system will also continue and extend present credit mechanisms to strengthen the economic potential of the less prosperous countries of the Community.

EMS, according to the Council resolution, will be open to all European countries with particularly close economic and financial ties with the European Community. Because of its international implications, EMS will require coordination of exchange policies with third countries and concertation with their monetary authorities. The system will remain fully compatible with the International Monetary Fund; it is expected to lessen speculation among European currencies and thereby aid the U.S. dollar.

Plans for the EMS were put forward this year by German Chancellor Helmut Schmidt and French President Valery Giscard d'Estaing following a call last year by Commission President Roy Jenkins for renewed steps toward European monetary union.

A complete text of the Council resolution on EMS is reprinted below:

A.

1.) Introduction -

In Bremen we discussed a "scheme for the creation of closer monetary cooperation leading to a zone of monetary stability in Europe." We regarded such a zone "as a highly desirable objective" and envisaged "a durable and effective scheme."

Today, after careful examination of the preparatory work done by the Council and other Community bodies, we are agreed as follows: A European Monetary System (EMS) will be set up on 1 January 1979.

We are firmly resolved to ensure the lasting success of the EMS by policies conducive to greater stability at home and abroad for both deficit and surplus countries.

The following chapters deal primarily with the initial phase of the EMS.

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 6/7 July 1978, as well as the full utilization of the ECU as a reserve asset and a means of settlement. It will be based on adequate legislation at the Community as well as the national level.

2.) The ECU and its functions -

A European Currency Unit (ECU) will be at the center of the EMS; the value and the composition of the ECU will be identical with the value of the EUA* at the outset of the system.

*The European Unit of Account (EUA) is a composite basket of fixed amounts of currencies of the nine Member States as follows:

0.028	German marks,
1.15	French francs,
0.0885	Pounds sterling,
109	Italian lira,
0.286	Dutch florins,
3.66	Belgian francs,
0.140	Luxembourg francs,
0.217	Danish crowns,
0.00759	Irish pounds.

The equivalent of the EUA in any currency is equal to the sum of the equivalents of these amounts in that currency.

The ECU will be used -

- a.) As the denominator (numeraire) for the exchange rate mechanism
- b.) As the basis for a divergence indicator
- c.) As the denominator for operation in both the intervention and the credit mechanism
- d.) As a means of settlement between monetary authorities of the EC.

The weights of currencies in the ECU will be reexamined and if necessary revised within six months of the entry into force of the system and thereafter every five years or, on request, if the weight of any currency has changed by 25 per cent.

Revisions have to be mutually accepted. They will, by themselves, not modify the external value of the ECU. They will be made in line with underlying economic criteria.

3.) The exchange rate and the intervention mechanism -

Each currency will have an ECU-related central rate. These central rates will be used to establish a grid of bilateral exchange rates.

Around these exchange rates fluctuation margins of 2.25 per cent will be established. EC countries with presently floating currencies may opt for wider margins up to 6 per cent at the outset of EMS. These margins should be gradually reduced as soon as economic conditions permit to do so.

A member state which does not participate in the exchange rate mechanism at the outset may participate at a later date.

Adjustments of central rates will be subject to mutual agreement, a common procedure which will comprise all countries participating in the exchange rate mechanism and the Commission. There will be reciprocal consultation in the Community framework about important decisions concerning exchange rate policy between countries participating and any country not participating in the system.

In principle, interventions will be made in participating currencies. Intervention in participating currencies is compulsory when the intervention points defined by the fluctuation margins are reached.

An ECU basket formula will be used as an indicator to detect divergences between Community currencies. A "threshold of divergence" will be fixed at 75 per cent of the maximum spread of divergence for each currency. It will be calculated in such a way as to eliminate the influence of weight on the probability to reach the threshold.

When a currency crosses its "threshold of divergence," this results in a presumption that the authorities concerned will correct this situation by adequate measures, namely:

- a.) Diversified intervention,
- b.) Measures of domestic monetary policy,
- c.) Changes in central rates,
- d.) Other measures of economic policy.

In case such measures, on account of special circumstances, are not taken, the reasons for this shall be given to the other authorities, especially in the "concertation between central banks." Consultations will, if necessary, then take place in the appropriate Community bodies, including the Council of Ministers.

After six months these provisions shall be reviewed in the light of experience. At that date the questions regarding imbalances accumulated by divergent creditor or debtor countries will be studied as well.

A very short-term facility of an unlimited amount will be established. Settlements will be made 45 days after the end of the month of intervention with the possibility of prolongation for another 3 months for amounts limited to the size of debtor quotas in the short-term monetary support.

To serve as a means of settlement, an initial supply of ECU will be provided by the European Monetary Cooperation Fund (EMCF) against the deposit of 20 per cent of gold and 20 per cent of dollar reserves currently held by central banks.

This operation will take the form of specified, revolving swap arrangements. By periodical review and by an appropriate procedure it will be ensured that each central bank will maintain a deposit of at least 20 per cent of these reserves with EMCF. A member state not participating in the exchange rate mechanism may participate in this initial operation on the basis described above.

4.) The credit mechanisms -

The existing credit mechanisms with their present rules of application will be maintained for the initial phase of the EMS. They will be consolidated into a single fund in the final phase of the EMS.

The credit mechanisms will be extended to an amount of 25 billion ECU of effectively available credit. The distribution of this amount will be as follows:

Short-term monetary support	14 billion ECU
Medium-term financial assistance	11 billion ECU

The duration of the short-term monetary support will be extended for another 3 months on the same conditions as the first extension.

The increase of the medium-term financial assistance will be completed by 30 June 1979. In the meantime, countries which still need national legislation are expected to make their extended medium-term quotas available by an interim financing agreement of the central banks concerned.

5.) Third countries and international organizations -

The durability of EMS and its international implications require coordination of exchange rate policies vis-a-vis third countries and, as far as possible, a concertation with the monetary authorities of those countries.

European countries with particularly close economic and financial ties with the European Communities may participate in the exchange rate and intervention mechanism.

Participation will be based upon agreements between central banks. These agreements will be communicated to the Council and the Commission of the EC.

EMS is and will remain fully compatible with the relevant articles of the International Monetary Fund agreement.

6.) Further procedure -

To implement the decision taken under (A), the European Council requests the Council to consider and to take a decision on 18 December 1978 on the following proposals of the Commission:

(A) Council regulation modifying the unit of account used by the European Monetary Cooperation Fund, which introduces the ECU in the operations of the European Monetary Cooperation Fund and defines its composition.

(B) Council regulation permitting the EMCF to receive monetary reserves and to issue ECUs to the monetary authorities of the member states which may use them as a means of settlement.

(C) Council regulation on the impact of the European Monetary System on the Common Agricultural Policy. The European Council considers that the introduction of the EMS should not of itself result in any change in the situation obtaining prior to 1 January 1979 regarding the expression in national currencies of agricultural prices, monetary compensatory amounts (MCAs) and all other amounts fixed for the purposes of the Common Agricultural Policy.

The European Council stresses the importance of henceforth avoiding the creation of permanent MCAs and progressively reducing present MCAs in order to reestablish the unity of prices of the Common Agricultural Policy, giving also due consideration to price policy.

It requests the Commission to submit in good time a proposal to amend the Council decision of 22 March 1971 on the introduction of a mechanism for the medium-term financial support to enable the Council of Economics and Finance Ministers to take a decision on such proposal at their session of 18 December 1978.

It requests the central banks of member states to modify their agreement of 10 April 1972 on the reduction of margins of fluctuation between the currencies of member states in accordance with the rules set forth above (see paragraph 3).

It requests the central banks of member states to modify as follows the rules on short-term monetary support by 1 January 1979 at the latest:

- a.) The total of debtor quotas available for drawings by the central banks of member states shall be increased to an aggregate amount of 7.9 billion ECU,
- b.) The total of creditor quotas made available by the central banks of member states for financing the debtor quotas shall be increased to an aggregate amount of 15.8 billion ECU,
- c.) The total of the additional creditor amount as well as the total of the additional creditor amount may not exceed 8.8 billion ECU.
- d.) The duration of credit under the extended short-term monetary support may be prolonged twice for a period of 3 months.

B. Measures designed to strengthen the economies of the less prosperous member states of the European Monetary System

We stress that, within the context of a broadly-based strategy aimed at improving the prospects of economic development and based on symmetrical rights and obligations of all participants, the most important concern should be to enhance the convergence of economic policies toward greater stability. We request the Council (Economic and Finance Ministers) to strengthen its procedures for coordination in order to improve that convergence.

We are aware that the convergence of economic policies and of steps must be taken to strengthen the economic potential of the less prosperous countries of the Community. This is primarily the responsibility of the member states concerned. Community measures can and should serve a supporting role.

The European Council agrees that, in the context of the European Monetary system, the following measures in favor of the less prosperous member states effectively and fully participating in the exchange rate and intervention mechanisms will be taken.

The European Council requests the Community institutions by the utilization of the new financial instrument and the European Investment Bank to make available for a period of 5 years loans of up to 1 billion EUA per year to these countries on special conditions.

The European Council requests the Commission to submit a proposal to provide interest-rate subsidies of 3 per cent for these loans, with the following elements: The total cost of this measure, divided into annual tranches of 200 million EUA each over a period of 5 years shall not exceed 1 billion EUA.

Any less prosperous member country which subsequently effectively and fully participates in the mechanisms would have the right of access to this facility within the financial limits mentioned above. Member states not participating effectively and fully in the mechanisms will not contribute to the financing of the scheme.

The funds thus provided are to be concentrated on the financing of selected infrastructure projects and programs, with the understanding that any direct or indirect distortion of the competitive position of specific industries within member states will have to be avoided.

The European Council requests the Council (Economics and Finance Ministers) to take a decision on the above mentioned proposals in time so that the relevant measures can become effective on 1 April 1979 at the latest. There should be a review at the end of the initial phase of the EMS.

The European Council requests the Commission to study the relationship between greater convergence in economic performance of the member states and the utilization of Community instruments, in particular the funds which aim at reducing structural imbalances. The results of these studies will be discussed at the next European Council.

In remarks at a Tuesday press conference at the conclusion of the Council, President Jenkins termed the two-day meeting "a success in getting a European Monetary System worked out in detail, with a full measure of agreement." He acknowledged that the likelihood of immediate British participation had been small, and expressed his disappointment that Italy and Ireland had been unable to indicate their willingness to join at the Brussels meeting.

Belgium, Denmark, France, Germany, Luxembourg and the Netherlands announced at the Council that they would participate in the EMS from the January 1 starting date. Italy and Ireland are expected to reach a decision within one or two weeks.

Jenkins emphasized his belief that the EMS "should be a Community scheme" and he said it was important "to start on a basis of a Community scheme which makes the possibility of others joining easier." He affirmed that the Commission "will play its full part and will do its best to represent the common collective interest."