European Community

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BACKGROUND NOTE

INTRODUCTION OF EUROPEAN MONETARY SYSTEM DELAYED

Text of Resolution

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The formal start of the European Monetary System (EMS), planned for 1 January 1979, has been delayed until difficulties in applying the system to the common agricultural policy have been resolved.

Eight EC member countries - Belgium, Denmark, France, Germany, Ireland, Italy, Luxembourg and the Netherlands - will then operate the system which will:

- have at its centre a European Currency Unit (ECU);
- incorporate a compulsory intervention mechanism to ensure greater stability of European exchange rates;
- continue and extend present credit mechanisms to strengthen the economic potential of the less prosperous EC countries;
- be open to all European countries with particularly close economic and financial ties with the European Community;
- because of its international implications, require coordination of exchange policies with non-EC countries and concertation with their monetary authorities;
- remain fully compatible with the International Monetary Fund.

Because it is expected to lessen speculation among European currencies, EMS should thereby aid the U.S. dollar.

Plans for the EMS were put forward in 1978 by German Chancellor Helmut Schmidt and French President Valery Giscard d'Estaing, following a call in 1977 by Commission President Roy Jenkins for renewed steps toward European monetary union.

The text of the resolution on the EMS adopted by the European Council (heads of government of the nine EC countries) in Brussels on 5 December, and explanatory background material, are given on the following pages.

NR (79) 2
11 January

Resolution of the European Council of 5 December 1978 on the establishment of the European Monetary System (EMS) and related matters

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 (European Currency Unit) 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.

The ECU and its functions

A European Currency Unit (ECU) will be at the centre of the EMS. The value and the composition of the ECU will be identical with the value of the EUA (European Unit of Account) at the outset of the system.

The ECU will be used

- as the denominator (numéraire) for the exchange rate mechanism;
- as the basis for a divergence indicator;
- as the denominator for operations in both the intervention and the credit mechanisms;
- as a means of settlement between monetary authorities of the EC.

The weight of currencies in the ECU will be re-examined 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.

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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 by 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:

- diversified intervention,
- measures of domestic monetary policy,
- changes in central rates,
- 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".

Consultation 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.

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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 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 the European Monetary Cooperation Fund. A member state not participating in the exchange rate mechanism may participate in this initial operation on the basis described above.

The credit mechanism

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 mechanism 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.

Third countries and international organizations

The durability of EMS and its international implications require co-ordination 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 IMF agreement.

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Further procedure

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

- Council regulation modifying the unit of account used by the European Monetary Cooperation Fund, which introduces the ECU in the operations of the EMCF and defines its composition,
- 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,
- 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 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(Monetary Compensation Amounts) and progressively reducing present MCAs in order to re-establish 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 on the exchange rate and the intervention mechanism).

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:

- 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.

- 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.

- The total of the additional creditor amount as well as the total of the additional debtor amount may not exceed 8.8 billion ECU.

- 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 towards 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 economic performance will not be easy to achieve. Therefore, 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 favour of the less prosperous member states effectively and fully participating in the exchange rate and interventions 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 1000 million 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 1000 million 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 programmes, 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 (Economic 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.

Notes on the application of the Resolution

1 - Sterling will be included with other Community currencies in the ECU, since the ECU will be identical with the European Unit of Account (EUA), which is a basket of all Community currencies. At present 1 ECU/EUA is worth about Can. $1.60.

2 - The loans designed to strengthen economies of less prosperous member states will be made available to countries participating in the exchange rate mechanism. They will be made by the European Investment Bank or under the Ortoli facility, in which loans are raised by the Commission and administered jointly with the EIB. The total of loans made available would be up to 1,000 m EUA a year for each of five years, with an interest rate subsidy of 3 per cent. The cost of interest rate subsidy should not be more than 200m EUA per year for five years.

As long as the UK does not participate in the exchange rate mechanism, it does not qualify for these subsidized loans, but nor does it contribute towards their cost.

3 - Since the introduction of the common agricultural policy, official agricultural prices in the Community have been fixed in units of account (u.a.), which were initially given a certain value in gold and were subsequently valued in terms of Community currencies with declared fixed parities (the "snake" currencies).

As from 1 January 1979, the unit of account should have been replaced by the European Unit of Account for the purposes of denominating official farm support prices. Since it is a basket of all Community currencies, the EUA value will reflect movements in value of all EC currencies.

The EUA is worth less than the u.a., but EC Heads of Government agreed in their Resolution that this change should not lead to any sudden drop in prices, nor any immediate redistribution of the monetary compensatory amounts. The actual figures would therefore be increased by 21 per cent, so the value of prices in EUA would be equivalent to the old figure in u.a. and there would be no sudden changes for producers or consumers.
