european community BACKGROUND INFORMATION

EUROPEAN COMMUNITY INFORMATION SERVICE 2100 M Street NW, Washington DC 20037 phone (202) 296 - 5131
New York Office: 155 East 44th Street, New York, N.Y. 10017 phone (212) MU 2-0458

No. 9

March 29, 1972

BACKGROUND INFORMATION

# COMMON MARKET APPROVES IMPORTANT STEP TOWARDS ECONOMIC AND MONETARY UNION

WASHINGTON, D.C., MARCH 29 -- The European Community's Council of Ministers on March 21 formally approved a plan which is an important step towards economic and monetary union and reinstitutes a unified approach to stabilization of international monetary affairs.

Sidetracked by the international monetary crisis of the past 10 months, the Common Market's drive for economic and monetary union has been revived by the Council agreement which will, in effect, establish a Community "independent monetary area" within the international monetary system.

The agreement commits the Common Market countries to reduce the maximum gap between the exchange rates of the highest and lowest quoted EC currencies to 2.25 per cent by July 1, 1972. This major step towards closer economic and monetary cooperation had been given tentative approval by the member states' finance ministers on March 7.

The accord should pave the way for better coordination of the individual member states economies and could eventually lead to creation of a common European currency.

Under the agreement reached by the "Group of Ten" major industrial countries December 18 in Washington, major currencies could float 2.25 per cent above and 2.25 per cent below their new official values. With this general margin of 4.5 per cent, the maximum fluctuation between two Common Market currencies could theoretically be 9 per cent, if one country devalued 4.5 per cent and another country's currency appreciated 4.5 per cent. Such a change would seriously disrupt the administration of the Common Agricultural Policy.

The Community's agreement will permit member states currencies to fluctuate among themselves only 1.125 per cent above or below their new official values (for a 2.5 per cent total), half the margin approved by the Group of Ten. European central banks, which would have to intervene to maintain the 2.25 per cent range, will be responsible for working out the details of intervention and debt settlement. The 4.5 per cent maximum fluctuation range would still apply to Community currencies as a group vis-a-vis the US dollar.

During the initial "experimental" phase of the Community Plan, central bankers will designate a day after which interventions on the members' foreign exchange markets will be made in Community currencies based on exchange rates of that date. Subsequently, Community central bankers will continue to narrow fluctuation margins by their interventions in the foreign exchange market, aiming for a margin of 2.25 per cent by July 1, 1972. Without specifying goals to be reached after July 1, the Council said that ". . .the elimination of all fluctuation margins between Community currencies remains the long-term objective."

Economic and Monetary Policy Coordination

Under the agreement, the Council established a "Coordination Group" consisting of the member countries' special representatives or their finance ministers, and a representative of the Commission "to ensure reciprocal and constant information on the member states' short-term economic and financial policies and the coordination of these policies within the framework of economic policy guidelines defined by the Council."

As the result of a decision last March, the Council of finance ministers currently meets three times a year to establish short-term economic guidelines in the fields of incomes, credit, investment, and budgetary policies. Prior to taking action contrary to Council guidelines, member states have agreed to consult with the newly-formed coordination group. The chairmen of the Short-term Economic Policy Committee, the Monetary Committee, and the Budgetary Policy Committee will assist the Coordinating Group which will also work closely with the Committee of Permanent Representatives to prepare the tri-annual Council sessions.

Anti-Speculation Measures

As part of the Community's resolution to coordinate national policies, the Council adopted a directive designed to protect Community economies from destabilizing capital flows caused by speculation. According to the directive, national monetary authorities will be given instruments to regulate capital inflows and to neutralize their negative effects. The authorities will be granted the power to regulate:

- investment in the money market and repayment of non-residents' deposits
- borrowing unassociated with commercial transactions or the provision of services contracted abroad by residents
- the lending power of credit institutions according to net assets
- compulsory reserve requirements, especially for non-residents' bank accounts.

Regional Development Fund Still Pending

The Council's resolution adhered to the Commission proposal in most cases with one major qualification, the proposed creation of a regional development fund. The Council agreed that either a fund should be created or "that an entirely different system of resources should be established to finance regional development." The Council also agreed to use funds from the Agricultural Guidance and Guarantee Fund for regional development.

The Council invited the Commission to propose measures to solve the most urgent regional development problems and pledged to act on the proposals before October 1, 1972.

The Monetary Committee and the Committee of Governors of Central Banks were requested by the Council to draw up a report on the organization, functions, and statutes of a European Monetary Cooperation Fund by June 30, 1972. The Fund would coordinate central bank interventions on the money markets and harmonize their reserve policies. The Council will rule on the report before the end of the year.

The Council also agreed to consider Commission proposals on fiscal harmonization and a European capital market within six months after they are placed on the Council's agenda.

Hopes Renewed

The Community countries' pledge of unity prompted renewed hopes for economic and monetary union, an idea introduced to the Council by the Commission three years ago.

Last March, the Council passed a similar though less detailed resolution to work toward union, but plans lost momentum in May of 1971 when Germany and the Netherlands decided to float their currencies. The US announcement on August 15 to sever the dollar's tie to gold further disrupted an already shaky international monetary system and created an atmosphere even less conducive to European unity on economic matters.

Although the Washington accord reintroduced a semblance of order to international money markets, Community officials expect a European monetary area to restore even greater stability to the international monetary system. On leaving the March 7 Council meeting, French Finance Minister Valery Giscard d'Estaing lauded "the new role European currencies will play in stabilizing international financial relations."

Unofficial Translation

The following is the text of the resolution approved by the Council March 21.

I

With a view to reinforcing the efficient implementation of the Council's decision of March 22, 1971, concerning the strengthening of the coordination of the member states' short-term economic policies, the following measures have been decided:

1) In all cases where a member state is considering measures or decisions which differ from the economic policy directions set forth by the Council, consultations will take place before the implementation of these measures or decisions, within the Coordination Group mentioned in point 2, below.

2) To ensure reciprocal and constant information on the member states' short-term economic and financial policies, and to ensure coordination of these policies in the framework of the economic policy defined by the Council, a Coordinating Group will be created within the Council. This group will be composed of one special representative of the appropriate minister for each member state, and of a representative of the Commission. The chairmen of the Short-Term Economic Policy Committee, of the Monetary Committee and of the Budget Policy Committee will also attend the meetings of the coordination group if necessary. This group will work in close cooperation with the Committee of Permanent Representatives, particularly for the preparation of the three Council sessions devoted to the coordination of economic policies, as well as for the Council sessions devoted to the preliminary consultations mentioned in point 1.

3) After taking note of the opinions of the appropriate committees, the Commission will present to the Council, as soon as possible, a draft directive intended to promote stability, growth and full employment in the Community.

II

So as to start without delay the actions of a structural and regional character necessary to the eventual realization of the monetary and economic union, the Council approved, in principle, the following measures:

1) Funds from the European Agricultural Guidance and Guarantee Fund will be used in 1972 for regional development activities.

2) A regional development fund should be created, or another system should be set up to devote the adequate Community resources to regional development.

The Council invites the Commission to set forth proposals in conformity with point III (4) of the March 22 resolution. It will make the necessary decisions on the Commission's proposals before October 1, 1972.

III

1) To take a first step towards the formation of an individualized monetary area within the framework of the international system, the Council invites the member states central banks, while using fully the fluctuation margins allowed by the International Monetary Fund on the world level, to reduce progressively the margins existing at a given moment between the rates of the highest and lowest currencies of the member states.

Accordingly, during a first stage when procedures will be tested, the central banks are invited to act on the respective exchange markets according to the following principles:

a) Starting on a date to be set by the central bank governors, interventions will be carried out with Community currencies, on the basis of margins existing in the markets on that date.

b) As these limits become more and more reduced, the margins mentioned in point (a), above, will be reduced and will not again be widened.

c) By July 1, 1972, at the latest, the difference at a given moment between two member states' currencies may not exceed 2.25 per cent.

In conformity with the Council's resolution of March 22, 1971, the elimination of all fluctuation margins between Community currencies remains the long-term objective.

2) To achieve this, the central banks are invited to operate on their countries' currencies markets according to the following principles:

a) in Community currencies, if their rates reach on the currency market concerned, the maximum fluctuation limit authorized in point 1

b) in US dollars, if the rate of the dollar on the currency market concerned reaches the maximum fluctuation limit authorized by the International Monetary Fund regulations

c) within these limits of fluctuation, only after a concerted decisions from the central banks.

3) The Central Banks are invited to settle debts resulting from operations in Community currencies during a period of one month. Any exceptions to this rule will have to be agreed upon within the Committee of Central Banks Governors. The way these settlements will be done will depend on the structure of the debtor country's monetary reserve.

4) In the present circumstances, the Council considers it important for the Monetary Committee and the Committee of Central Bank Governors to set forth by June 30, 1972, at the latest, a report on the organization, the functions, and the statutes of a European monetary cooperation fund, in conformity with point III (8) of the Council's resolution of March 22, 1971.

The Council will give an opinion on the conclusions of this report before the end of 1972.

5) So as to discourage excessive flows of capital and to neutralize their negative effects on internal liquidity, the Council adopts the directive proposed by the Commission on June 23, 1971, concerning the regulation of international financial flows and the neutralization of their undesirable effects on internal liquidities.

IV

The Council has agreed that the proposals set forth by the Commission for the realization of the first stage of the economic and monetary union (particularly those concerning tax harmonization and progressive development of a European capital market) should be given priority on the Council's agenda. The Council will make a decision concerning these proposals within six months after their inclusion in its agenda.

# # #