THE EUROPEAN MONETARY SYSTEM

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I. Introduction

A. Money and the Treaty of Rome

1. The European Monetary System has to be seen in the framework of European integration and of the European Economic Community. Applying a legal approach to the subject, it therefore suggests itself to start with looking for provisions having an impact on European monetary matters in the Treaty of Rome.[1] The authors of this Treaty, however, did not pay much attention to monetary problems. The faw provisions of the Treaty, which refer to monetary questions, are for from establishing a full - fledged monetary system among the member states (Arts. 67-73 and 104-109). Also the establishment of a European Monetary System is not mentioned among the principles of the Community.[2] What can be derived from the provisions of the Treaty of Rome has been called a monetary

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[1] The Treaty establishing the European Economic Community (Common Market) has been signed on March 25, 1975 in Rome and entered into force on January 1, 1958. The international source is: UNTS Vol. 298 p. 11. The original text underwent some amendments over the years and some of its provisions were repealed. For the text of the relevant amendments and of other changes in the original treaty, a convenient source is the Common Market Reporter or the Encyclopedia of European Community Law. States parties to the Treaty are: Belgium, Denmark, Federal Republic of Germany, France, Greece, Ireland, Italy, Luxembourg, the Netherlands and the United Kingdom.

[2] Part One of the Treaty contains the principles. Art. 2 referring to the aims of the Community is the underlying norm, which is set out in more detail by the following Arts. 3-8. Art. 2 reads as follows:

code of conduct in embryo.[3] The chapters on the transfer of capital and on the balance of payments contain the relevant norms (Arts. 67-73 and 104-109). These differ much as to preciseness and intensity of the obligations of states parties. Thus states f.i. must admit free currant payments (Art. 106 par. 1), where as their obligations relating to free capital transfer are far vaguer. Free capital transfer is only required to "the extent necessary for the good functioning of the Common Market" (Art. 67 par. 1). The Treaty does not contain norms on the two basic components inherent in any international monetary system: exchange rates and mechanisms of cooperation.

2. Art. 107 par. 1 declares exchange rates "a matter of common interest". From the angle of the states this is considerable. Exchange rates are of high importance for and have a strong impact on the national economies. Therefore states tend to treat them as vitally concerning their vovereignty.[4] But in regard to establishing a European Monetary System one can hardly derive any legal obligation from Art. 107 par. 1 EEC Treaty, because that provision is so vague.[5] Also the internal economic policy of the states conditions the value of their moneys. But the Treaty refers to national economics only by stating objectives and in a way too imprecise to be operational. Art. 104 reads as follows:

> "Each Member State shall pursue the economic policy necessary to ensure the equilibrium of its overall balance of payments and to maintain confidence in its

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> "It shall be the aim of the Community, by establishing a Common Market and progressively approximating the economic policies of Member States, to promote throughout the Community a harmonious development of economic activities, a continious and balanced expansion, and increased stability, an accelerated raising of the standard of living and closer relations between its Member States."

[3] Carreau, **Vers une Zone de Stabilité Monétaire: La Création du Système Monétaire Européen au Sein de la C.E.E.**, 229 REVUE DU MARCHE COMMUN 399-417 at 400 (1979).

[4] See Artus & Crocket, **National Sovereignty and International Cooperation over Exchange Arrangements**, 12 CASE WESTERN RESERVE JOURNAL INTERNATIONAL LAW 327-339 (1980).

currency, while ensuring a high level of employment and the stability of the level of prices."

These praiseworthy aims underly most national policies anyway.[6]

3. The second component inherent in any monetary system are mechanisms of cooperation both between the member states and between the states and common monetary authorities.

a. Art. 105 requires the states to coordinate their economic policies. For this purpose they institute a collaboration between the competent services of their administrative departments and between their centralbanks on the basis of recommendations by the Commission to the Council (Art. 105 par. 1). But in the absence of a supranational authority, which could have imposed the harmonization of national economic policies, and taken into account the very different economic and political situations within the member states a real coordination of politics could hardly be expected. A Monetary Committee with consultative status, however, has been established on the basis of Art. 105 par. 2. In the general framework of promoting the coordination of policies the Committee is to follow the monetary and financial situations of member states, to report regularly thereon and to formulate opinions for submission to the Council and the Commission. This Committee has proved to be a useful forum for the confrontation of the viewpoints and the experiences of the states parties in monetary affairs.[7]

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[5] So also Carreau, note 3. It is interesting to note, that the Court of Justice of the European Communities has denied any direct effect of Art. 107 within the member states for lack of preciseness (aff. 9-73, arrêt du 24.X.1973, Rec. 1135 and 1136 (1973); aff. 10-73, arrêt du 34.X.1973, Rec. 1175 and 1195 (1973)).

[6] Art. 109 par. 2 as amended of the Constitution of the Federal Republic of Germany and sentence 2 of the Statute for the Promotion of the Stability and the Growth of the Economy (1973) mention the following aims: the stability of the level of prices, a high level of employment, external equilibrium and steady and appropriate growth of the economy.

[7] On that Moussis, **Le Cadre Juridique des Politiques Communautaires: I. Politique Monétaire**, REVUE DU MARCHE COMMUN 385-389 at 385/6 (1982).

b. The Treaty of Rome contains only two provisions on mechanisms of cooperation between the member states and common monetary authorities: Arts. 108 and 109. That is strikingly meager taken into account the central role the International Monetary Fund attributes to mechanisms of assistance for members facing an external balance of payments crisis[8]. Arts. 108 and 109 of the EEC Treaty do not even specify the volume of credits to be given and the conditions to be applied on the receiving countries.

As a result - no European Monetary System has been established by the Treaty of Rome. More than ten years still had to elapse after the formation of the European Community in 1957 before even steps were taken towards the creation of the EMS.

B. Historical background of the European Monetary System

1. The Barre plan, which was adopted in February 1969 by the European Council, can be considered the starting point of the EMS.[9] For the first time emphasis was put on what is now deemed determining the success of the system: the convergence of national economic policies.[10] The parallelism between economic and monetary matters was from then on the underlying concept of all further steps towards the establishment of a full-fledged monetary system. The Barre plan proved very successful. It suggested mechanisms of cooperation in order to increase monetary solidarity within the EEC. The instruments established accordingly, the short-term monetary support (1970) and the medium-term financial assistance (1971), have survived. Without having been changed significantly they now constitute two basic pillars of the EMS.[11]

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[8] On the mechanisms of the IMF: D. Carreau, **Le Fonds Monétaire International** 167-233 (1970).

[9] More on the Barre plan at Carreau, **La Communauté Economique Européenne Face aux Problèmes Monétaires**, REVUE TRIMESTRIELLE DE DROIT EUROPEEN 586 at 593-603 (1971).

[10] On the importance of economic convergence, see Boyer de la Giroday, **The European Monetary System**, 12 EUROPEAN CURRENCY 7-128 at 13-37 (1981-1982).

[11] Below pp. 20-23.

2. The spectacular success of the Barre plan led to overshooting the mark. At the The Hague Conference of December 1 and 2, 1969 the heads of state and government decided on a plan to establish an Economic and Monetary Union. Several proposals were made specifying the structure of that union. The most famous one is the Werner Report by the then Prime Minister of Luxembourg M. Pierre Werner.[12] That report most relevantly inspired the Resolution of the Council of Ministers of the EEC of March 22, 1971, which contained the constitutive charter of an economic and monetary union.[13] Major features were: total and irreversible convertibility of the currencies, the elimination of margins of fluctuation of the exchange rates, the irrevocable fixing of the parity relations, the creation of conditions indispensable for the establishment of a unique currency and allowing a common organization of central banks. The realization of this program would have required a definite transfer of the necessary competences to the community organs and would have led to a limited federal system. The difficulties and the unavoidable failure of the European Monetary Union result from the fact that the time was not ripe for the necessary renunciation of sovereignty by the member states. Until today the political will for so fare-going a transfer of powers to supranational organs can by no way be presumed.

3. One therefore was thrown upon a piecemeal approach. The following steps are worth mentioning: The creation of the famous "snake" (April 10.1972),[14] the institution of a European Fund for Monetary Cooperation (April 3, 1973),[15] the Commu-

[12] Text of the Werner plan: Supplement to: 1 BULLETIN OF THE EUROPEAN COMMUNITY (1970).

[13] Text of the resolution of the Council of Ministers: C 28/I JOURNAL OFFICIEL DES COMMUNAUTES EUROPEENNES (March 27, 1971). Moussis, **Le Cadre Juridique des Politiques Communautaires: I. Politique Monétaire,** REVUE DU MARCHE COMMUN 385-389 at 386/7 gives a short overview on the Werner plan and the resolution of March 22, 1971.

[14] On the snake: Wittich & Shiratory, Le **Serpent dans le Tunnel,** 10/2 FINANCES AND DEVELOPMENT 9-14 (1970) and K. Dam **The Rules of the Game** 193-194 and 329 (1982). Both explanations also deal with the position of the snake within the international monetary system, i.e. its position towards the dollar. See also below 27.

[15] On the European Fund for Monetary Cooperation (EMCF):

nity loans by the Commission to member states (Febr. 17, 1975),[16] the adoption of a European Unit of Account based on a basket of currencies (April 21, 1975)[17] and the creation of new facilities for borrowing and loans (Dec. 6, 1977).[18] Most important of these measures has been the creation of the "snake". It constitutes the first serious effort to stabilize the exchange rates within the EEC, member states agreeing to maintain a maximum margin of 2 1/4 percent against one another. Stabilizing the exchange rates implies similar inflation rates. Insofar the "snake" has been a move towards the paramountly important convergence of national economies. But the snake, as the European Monetary Union, has not been a success, several states not maching the demands of a comparable economic development.[19] Thus the "snake" finally shrank to a "mini-snake" around the German mark.[20] Nevertheless the "snake" has had its impact on the present European Monetary System, which is intended to be "at least as strict as the snake"[21] and sometimes is referred to as the "rattle-snake".[22]

Carbonetti, **The European Monetary System: A Legal Survey,** L. COCCIOLI (ed.) 107-115 at 107-109 (1980). Also below 26.

[16] SeeChronique du Droit International Economique, ANNUAIRE FRANÇAIS DE DROIT INTERNATIONAL 640 (1976).

[17] See **Chronique du Droit International Economique**, ANNUAIRE FRANÇAIS DE DROIT INTERNATIONAL 691-693 (1975).

[18] These are the so-called "Ortoli-facilities" established by a decision of the Council of Oct. 16, 1978. Text: JOURNAL OFFICIEL DES COMMUNAUTES EUROPEENNES L 298 (Oct. 25, 1978). On most of the mentioned institutions I will come back later since they are more or less forthexisting within the EMS.

[19] The pound sterling left the snake arrangement in 1972, the Italian lira in 1973, the French franc left twice and came in again.

[20] "mini-serpent" Carreau, **Vers une Zone de Stabilité Monétaire: la Création du Système Monétaire au Sein de la C.E.E.**, 229 REVUE DU MARCHE COMMUN 399-417 at 402 (1979). See also K. Dam, **The Rules of the Game** 193/4 (1982). Participants left at the end were: Belgium, Denmark, the Federal Republic of Germany, Luxembourg and the Netherlands.

[21] Par. 1 of the Bremen Statement of the European Council on the Establishment of a European Monetary System (July 6 and 7, 1978). The text is reprinted as **Part B: Documents** of Ethier & Bloemfield, **The European Monetary System,** 3 EUROPEAN ECONOMY (1979) 65-111 at 93.

[22] "serpent à sonnette" Carreau, **Vers une Zone de Stabilité Monétaire,** 229 REVUE DU MARCHE COMMUN 399-417 at 402 (1979).

4. The European Monetary System has been worked out on the initiative of the French President Giscard d'Estaing and of the German Chancellor Schmidt. They made the decisive proposal on the meeting of the European Council in Copenhagen on April 7 and 8, 1978, to which consequence was given on the Bremen meeting of July 6 and 7, 1978. In Bremen the main features of the EMS were laid down. They can be resumed as follows: The new system would be "at least as strict as the 'snake' ". It would be open to nonmember countries on an associate basis. A European Currency Unit (ECU) would be at the centre of the system. It would be based on a considerable supply of assets, central banks of the participating states depositing part of their reserves with it, and finally the EMS would depend on the responsibility of deficit and surplus countries alike.[23]

From a juridical point of view it is interesting to note, that the EMS has been installed outside the organs of the Community.[24] Also resolutions of the European Council, a political organ, are by no means binding. The legal foundations of the EMS are acts by the Community organs, which implement the political will of the chiefs of state and government manifested at their meetings as the "European Council".[25] There have been regulations by the Commission concerning the European Monetary Cooperation Fund and the new ECU, a decision by the Council of Ministers modifying the amount of the medium-term financial assistance and furthermore two agreements between the central banks on the functioning and the managing of the new EMS and the short-term monetary support.[26] This combi-

[23] Read the **Annex to the Conclusions of the Presidency of the European Council of 6 and 7 July 1978 in Bremen**, which is reproduced as an annex to this paper.

[24] The European Council (which is not to be mixed up with the Council of Europe in Strasbourg) is not an EEC organ, but the more or less regular meeting of the chiefs of state and government of the member states of the EEC. These meetings are mentioned nowhere in the treaties, but have developed in practice.

[25] The organs of the Communty act by way of regulations, directives, decisions and —non bnding— recommendations and opinions, Art. 189 EEC Treaty.

[26] All these documents can be found in: EUROPEAN MONETARY SYSTEM, COLLECTED TEXTS, edited by the COMMITTEE OF THE

nation of high-level political statements and their legally relevant enactment in the administrative sphere of the Community organs has resulted in a very unspectacular introduction of the EMS. There have been no parliamentary debates on this important step towards European integration. It would have been otherwise, if the EMS had been established by an international treaty.[27]

Another legally interesting point is, that states are free to join or not to join the system and that "... countries currently not participating in the 'snake' may opt for somewhat wider margins around central rates."[28] Thereby the principle of equal treatment of all EEC members has been abandonned officially for the first time. This approach, which takes into account the different economic situations of the states, has been called "Europe at several speeds".[29]

Full monetary integration in Europe is intended to be achieved in two phases. What has been described above only concerns the initial phase, conceived as being provisional. The second phase, which was supposed to begin in 1981, would involve the extensive use of the ECU and the establishment of a European Monetary Fund instead of the present European Monetary Cooperation Fund.[30] Until now, 1983, the EMS has not reached its second phase. The European Monetary System today basically depends on two broad complexes: the European Currency Unit, the exchange rate and intervention system and

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PRESIDENTS OF THE CENTRALBANKS OF THE MEMBER STATES OF THE EEC AND THE EUROPEAN FUND FOR MONETARY COOPERATION (1979). They are also reprinted as Part B: Documents of Ethier & Bloemfield, **The European Monetary System**, 3 EUROPEAN ECONOMY 6-111 at 93 ff (1979).

[27] On the legality both on the national and the inter — or supranational plane of this "unspectacular" establishment of the EMS see Carreau, **Vers une Zone de Stabilité Monétaire**, 229 REVUE DU MARCHE COMMUN 399-417 at 404. The problem on the national plane is the lack of parliamentary participation. On the supranational plane Arts. 103, 107, 108 and 235, 236 of the EEC Treaty come into play. See below 28/9.

[28] Paragraph 1 of the Bremen Statement, see note 26.

[29] "Europe à plusieurs vitesses" Carreau, note 27 at 403.

[30] Below pp. 26-31 on the possible extension of the system.

the mechanisms of credit and assistance. They are the subject of the following chapters.

II. The ECU, the exchange rate and the intervention system

A. The ECU,[31] centerpiece of the System

1. Definition

The ECU has a key position in the system. When the EMS was installed the ECU was identical in structure and value with the former European Unit of Account. The European Unit of Account has been defined since 1975 as a basket of currencies. The individual shares were weighted according to the contributions of each member state to the EEC gross national product and to international trade. The basket system underlies the European Unit of Account and the ECU, its continuation, and also the Special Drawing Rights of the International Monetary Fund.[32] Using a basket of currencies has the advantage that

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[31] On the ECU, see K. Dam, **The Rules of the Game** 332-334 (1982); Guimbretiére, **Les Conditions d'un Marché de l'ECU**, 261 REVUE DU MARCHE COMMUN 529-543 (Nov. 1982); Hahn, **Das Europaeische Waehrungssystem-Systemvergleich und Funktionsweise-**, 14 EUROPARECHT 337-358 at 340 ff (1979); Rey, **The European Monetary System**, 17 COMMON MARKET LAW REVIEW 7-30 at 14-18 (1980). See also **Agreement between the Central Banks of the Member States of the EEC Laying Down the Operating Procedures for the European Monetary System** in: EUROPEAN MONETARY SYSTEM, COLLECTED TEXTS, edited by the COMMITTEE OF THE PRESIDENTS OF THE CENTRAL-BANKS OF THE MEMBER STATES OF THE EEC AND THE EUROPEAN FUND FOR MONETARY COOPERATION (1979), also reprinted as **Part B : Documents** of Ethier & Bloomfield, **The European Monetary System**, 3 EUROPEAN ECONOMY 6-111 at 102ff (1979). For an excellent comparative analysis of the SDR and the ECU, see J. Gold, **A New Universal and a New Regional Monetary Asset: SDR and ECU**, in 34 OESTERR. ZEITSCHRIFT FUER OEFFENTL. RECHT UND VOELKERRECHT 117-172 (1983).

[32] On SDRs: K. Dam, **The Rules of the Game** 151-169 (1982); J. Gold, **SDRs Currencies and Gold, Fifth Survey of New Legal Developments** 1-43 (1981); J. Polak, **Thoughts on an International Monetary Fund Based Fully on the SDR** 26 p. (1979); Silard, Money and Foreign Exchange, 17 INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW: STATE AND ECONOMY (B. BLAGOJEVIC & K. Dad eds.)

fluctuating exchange rates of individual currencies within the basket only affect the basket in proportion to their share.[33] When the EMS was created one ECU equalled one SDR of the International Monetary Fund. Since then the ECU has appreciated by about 1% against the SDR, according to the relative strength of the European currencies.

ECUs are created in a different way than the Special Drawing Rights of the IMF. Each EMS member was required at the outset to swap 20 percent of its gold and 20 percent of its gross dollar reserves against a credit for a corresponding number of ECUs on the books of the European Monetary Cooperation Fund. These swaps are renewable each three months, and adjustments in the amounts are to be made at the beginning of each quarter to maintain the 20 percent ratio and to take account of changes in gold price and the dollar rate.[34] The ECUs thus are backed by gold and dollars. The SDRs of the IMF, on the contrary, are allocated to participants in proportion to quotas, and the revolutionary aspect about SDRs has been that they are not backed by anything.[35] That led to some mistrust against a general use of the SDRs,36 whereas the fact, that ECUs are backed by gold and dollars might enhance the chances of their acceptance by the private sector.[37]

98-100 and, on a special problem, Silard, **Carriage of the SDR by Sea: the Unit of Account of the Hamburg Rules,** 10 JOURNAL OF MARITIME LAW AND COMMERCE 13-38 (1978).

[33] The share individual countries hold within the ECU basket can vary over the time. Part A No 2.3 of the **Resolution of the European Council of 5 Dec. 1978 on the Establishment of the European Monetary System (EMS)** provides that

> "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 %.
> 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."

[34] Art. 17 of the **EMS Central Banks Agreement,** see n. 31. Resume by K. Dam, **The Rules of the Game** 332/3 (1982).

[35] Dam, **ibid.** 151ff

[36] **ibid.** 152.

[37] **ibid.** 334.

2. Functions

The European Currency Unit has four main functions.[38]

a. The ECU serves as a unit of account. It became the only unit of account in the framework of transactions inherent to the functioning of the EMS. Insofar the ECU has replaced gold, which was the former unit of account of the EMCF, of the short-term monetary support and of the medium-term financial assistance.[39]

b. The ECU serves as a means of settlement between the monetary authorities of the European Community. Here the ECU exceeds the old European Unit of Account (EUA) and approaches the Special Drawing Right of the IMF. But SDRs are used by the IMF in exchange transactions with members, whereas the ECU, as a means of settlement, is limited to the authorities of the Community. Also, unlike the SDRs, ECUs are not envisaged to be used directly to obtain member states' currencies, except by agreement. Even in the case of debts arising out of the EMS credit facilities in the framework of exchange market intervention, the legal tender character of ECUs is limited to the extent that creditor central banks are not obliged to accept more than 50 percent of the settlement of the debt in ECU.[40] The practical utility of ECUs is moreover impaired by the swap arrangement making them subject to a 100 percent reconstitution each three months.[41] But the ECU gains upon the SDR in another respect. There has been a discussion ongoing with- in the IMF for a long time on the creation of a substitution account.[42] Countries participating would there deposit dollar reserves in return for the reserve

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[38] See Part A No 2.2 of the **Resolution of the European Council of 5 December 1978**, annex

[39] Comp. Carreau, **Vers une Zone de Stabilité Monétaire**, 229 REVUE DU MARCHE COMMUN 399-417 at 406.

[40] Art. 16 of the **Central Banks Agreement**, reference n. 31.

[41] On the foregoing, see K. Dam, **The Rules of the Game** 333 (1982).

[42] The Committee of Twenty established in 1972 with the IMF had suggested the establishment of a substitution account in its final report of 1974, see Committee of Twenty, **International Monetary Reform** 41f. No progress has been made on this problem, which is still on the agenda of the IMF, see BULLETIN OF THE IMF 65 (1979).

asset of the IMF, SDRs. Such a pooling of reserves already takes place in the EMS in a similar fashion, by depositing a given percentage of gold and of dollars in return for the reserve asset of the EMS, ECUs.[43] That has a mobilizing effect on the gold reserves of the members of the EMS.[44]

c. The ECU has two more important functions: It serves as a divergence indicator and as the common denominator of the EEC currencies for operations in both the intervention and the credit mechanism. These essential functions of the ECU will be explained within their operational framework as a subject of the following chapters.

B. The stabilization of exchange rates of the Community currencies[45]

The new exchange relations between the Community currencies participating in the EMS depend on the determination of a central rate, the establishment of a parity grid and of mechanisms of intervention.

1. The determination of a central rate in relation to the ECU

Each member state of the EMS determines a central rate of its currency in relation to the ECU. These central rates are not definitive. They can be changed in case of need. However, all modification is subject to mutual agreement and has to be performed in a common procedure, where both the states participating and the Commission take part. The requirement of accordance is inherent in the system. The ECU created an organic link between the currencies of the members to such a degree, that appreciation or devaluation of one currency affects the other currencies in a reverse way. The EMS procedure to

[43] Compare T. de Vries, **On the Meaning and Future of the European Monetary System**, 138 ESSAYS IN INTERNATIONAL FINANCE 15 (1980) and **Carreau, Vers une Zone de Stabilité Monétaire**, 229 REVUE DU MARCHE COMMUN 399-417 at 407.

[44] Carreau, **ibid.** "remonetarization of gold"; K. Dam, **The Rules of the Game** 333 (1982); de Vries, **ibid.** 25.

[45] On the following comp. Carreau, **Vers une Zone de Stabilité Monétaire**, 229 REVUE DU MARCHE COMMUN 399-417 at 407f (1979).

adjust exchange rates is a considerable progress taken into account, that states were usually regarded free to decide unilaterally on their exchange rates. By way of being dependent on the consent of their partners the member states of the EMS even lost all discretionary power in this fundamental domain. The expediency, the importance and the circumstances of an exchange rate adjustment now are fully subject to Community law. That implies a considerable abandonment of monetary sovereignty by the participating countries and by far exceeds the procedures set up by the IMF. Moreover all members of the EEC, those not participating in the EMS included,[46] have to consult each other on all important decisions concerning the exchange rate.[47]

2. The determination of the countries obliged to intervene

If nevertheless an exchange rate crisis arises, one has to decide which countries are under a duty to take adjustment measures. There are two approaches how to take that decision: There is a system of a bilateral parity grid and a system based on a basket of currencies.

a. The "snake" arrangement relied upon a parity grid, in which each currency is measured against each other's currency.[48] The band of permissible fluctuation was 2 1/4 percent under the snake. The intervention currencies are clearly indicated here, the ones which reach their inferior or superior margins of fluctuation, the one against the other. Both the weak and the strong currency are under an obligation to intervene. In spite of that, it was emphasized in the negotiations leading to the EMS, that the duty to intervene in a snake-type system laid more heavily with the weak currencies, because of the way of settlement. The central bank issuing the weak currency must buy back, at the exspiration of the credits given, whatever

46 In the moment that only concerns Great Britain.

47 For instance the determination of interest rates.

48 On the parity grid: Carreau, n. 45 at 410f; K. Dam, **The Rules of the Game** 330f (1982); Ethier & Bloemfield, **The European Monetary System,** 3 EUROPEAN ECONOMY 6-111 at 71 (1979). Dam and Ethier & Bloemfield also give a survey on the negotiations leading to the EMS.

amount of its own currency the strong-currency country purchased and pay back out of its reserves all gold and dollars it migt have borrowed. This applies with no regard whether the need to intervene stems from economic mismanagement in the weak-currency country or from external strains, like a weakness of the dollar. The arguments of the weak-currency countries were countered by the assertion, that intervention by the central banks issuing the strong currencies imposed constraints likewise, namely inflation. Notwithstanding a pure parity grid system was rejected for "assyımmetry" of the burden of adjustment.[49] One rather grafted onto the system of a grid of bilateral parities elements of the second, the basket type system.

b. In a basket type system the ECU has a double function.[50] It is the common denominator of the currencies forming the basket and futhermore determines the limits of intervention. Each currency thus is defined in ECU, that constituting its central rate. It then can float freely around the central rate within the margins allowed. Intervention becomes obligatory once the extreme floating limits are reached. This system has several advantages. It gives a decisive role to the ECU, what might facilitate its later monetary use. Moreover currencies are floating against an average and not, as in a system of a bilateral parity grid, against single, possibly eratically behaving currencies. That implies an additional element of stability. The problem, however, is the determination of the intervention currency. It may happen, that one country finds its currency at the superior limit of intervention without any other member country at the bottom. Also ECUs cannot be purchased and sold directly in the market. That would be the solution to the problem. One calls "involuntary debtors"[51] the countries whose currencies are then chosen for intervention. Another argument advanced against a basket system was the minor im-

[49] The argument that a parity grid system disadvantaged the weak-currency countries was most advanced by France. Germany on the contrary stressed the negative effect of an intervention by the central bank issuing the strong currency ("imported inflation").

[50] On the basket type system, see Carreau 409f and Ethier & Bloemfield 71, both references at note 48.

[51] Ethier & Bloemfield, note 48 at 71.

pact of the weaker currencies on the basket based central rates. The margins of fluctuation would reveal more stringent for the weaker-currency countries thereby.[52] What resulted from the discussions was a compromise.

c. The EMS pretty much continued to function like the snake, i.e. the bilateral parity grid defining the obligation to intervene.[53] But the system was supplemented by an objective indicator, based on the ECU basket approach, to signal when any particular country should undertake adjustment measures.[54] The objective indicator has been considered the most original aspect of the EMS.[55] It takes the form of a "divergence indicator" and will be the subject of the following chapter.

C. The intervention system

1. The ECU, indicator of divergence[56]

The ECU as an indicator of divergence creates for each currency a threshold of divergence at 75 percent of its maximum deviation under the parity grid.[57] The new system was to avoid the disadvantages of both, the bilateral parity grid and the basket based system. The supposed heavier economic burden on the weak-currency countries under a system of bilateral parities now was shifted to the authority issuing the currency

[52] Carreau, n. 45, gives the example, that an appreciation or devaluation of the German mark would cause a parallel, even though weakened evolution of the ECU, whereas an analogous move of the Irish pound would only have an infinitesimal impact on the value of the ECU.

[53] Comp. Carreau n. 45. at 411.

[54] This compromise was initially forwarded by Belgium.

[55] K. Dam, **The Rules of the Game** 331 (1982).

[56] On the divergence indicator, see: Part A No 3.5 and 3.6 of the **Resolution of the European Council of 5 Dec. 1978** and Art. 3 of the **Central Banks Agreement**, above note 26. See also K. Dam, **The Rules of the Game** 331f (1982); Carreau, n. 45 at 411 f; Ethier & Bloemfield, n. 26 at 74f and annex 3 at 85. With regard to the divergence indicator the EMS has been called the "rattle snake".

[57] Maximum deviation under the parity grid is for all countries forming the snake 2 1/4 percent. Other countries can be conceded wider margins taken into account their economic situation. These days only Italy profits from that with its 6 percent margin.

diverging most from the average. That could sometimes be the weak —currency countries and sometimes the strong— currency countries.[58] The drawback of a basket type system, the unequal constraint of the margins pursuant to the different weight of the currencies was neutralized too: the threshold of divergence in the EMS is reversely proportional to the coefficient of the weight of the currencies. The result is, that the more a country's currency weighs in the basket, the lower becomes its threshold of divergence.[59]

When a currency crosses its threshold of divergence this produces a presumption, not an obligation, to engage in "diversified intervention, measures of domestic monetary policy, changes in central rates and other measures of economic policy".[60] The measures to be taken are not specified in detail. "Diversified intervention" points to multicurrency intervention to avoid a perturbation of the exchange market of one single small country. A most frequent intervention object have been the interest rates.[61]

2. The intervention currency

Pursuant to the Bremen Statement of the European Council interventions are made in principle in participating currencies.[62] This rule also underlies the snake arrangement and corresponds to the whole movement's objective to promote European integration. Before the snake arrangement the US dollar was the "common" currency of the European countries to the extent that it was tthe only intervention currency under the rule of the IMF.[63] There existed no direct exchange rates between the European currencies. To defend the bilateral exchange rates of each of their national currencies under the EMS members now

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[58] See Ethier & Bloemfield, n. 26 at 71.

[59] Referring to the example given in note 52: Germany has a threshold of divergence of plus minus 1.13 percent and Ireland one of plus minus 1.67 pursuant to that system.

[60] Part A No 3.6 Central Banks Agreement, n. 26.

[61] Comp. Carreau, note 45 at 412.

[62] Part A No 3.3.

[63] On the dollar exchange rate regime, see K. Dam, **The Rules of the Game** 94f (1982). The snake and the EMS are compatible with the Articles of Agreement of the IMF. See below pp. 31f.

intervene in the participating currencies, which have reached their inferior or superior limit. But third currencies, practically the US dollar, continue to be used in intramarginal interventions, when only the divergence indicator is reached. Third currency intervention requires the consent of the state issuing.[64]

3. Accounting and settlement[65]

The credits and claims resulting from intervention in Community currencies are converted into ECUs and booked on the accounts of the European Monetary Cooperation Fund.[66] They bear an interest averaging the official discount rates of the nine member states of the EEC.[67] The debtor central bank has to pay in the first instance by means of holdings in the creditor's currency. If these holdings are not sufficient up to 50 percent of the debt can be settled in ECUs. The creditor central bank is not obliged to accept settlement by more than 50 percent in ECUs.[68] In case an intervention cannot happen because the debtor country is short of reserves, the way is open for the mechanisms of credit and assistance.

III. The mechanisms of credit and assistance

The EMS, in its first phase, incorporates and expands the three credit mechanisms established previously. In its final phase the mechanisms of credit and assistance would be concentrated upon the European Monetary Fund.[69] The three preexisting mechanisms are: the very short-term financing and the short-term monetary support, both of which are the responsibility of the central banks, and medium-term financial assistance, which is granted by the Council. The main features of

[64] Carreau, n. 45, at 413 calls the requirement of consent a costumary principle of monetary law.

[65] Compare Ethier & Bloemfield, n. 26, at 76 and Carreau, 45 at 413.

[66] On the EMCF see p. 26.

[67] Arts. 8 and 9 of the **Central Banks Agreement.**

[68] The remaining 50 percent might be settled by means of reserve components in accordance with the composition of the debtor central bank's reserves, i.e. SDRs or foreign exchange, **Art. 17 Central Banks Agreement.**

[69] On the EMF see pages 26-29 below.

the mechanisms, together with the changes made to them, are outlined below. A section on measures designed to strengthen the economies of the less prosperous countries and on Cmmunity loans will follow.

A. The very short-term financing[70] (VSTF)

The very short-term financing has to be seen in close context with the exchange rate and intervention mechanism. It has been established at the beginning of the snake in April 1972.[71] Under both arrangements, the snake and the EMS, central banks are under a duty to intervene in the exchange markets when reaching their limits on the bilateral parity grid. That presupposes sufficient liquidity of the central banks in foreign exchange. To that purpose the participating central banks have conceded each other short-term credit lines in national currencies in an unlimited amount. The operations were initially based in bilateral contracts in foreign currencies. Upon the installment of the EMS they have been centralized with the European Monetary Cooperation Fund and labelled in ECUs. Also the duration of the financing has been extended to 45 compared with 30 days previously. There is a possibility of prolongation for another three months subject to a ceiling equal to the debtor quotas in the short-term monetary support.

The right to very short-terms financing does not require any decision by the states or the community organs its trigger being the reach of the intervention point. As an unconditional right to financing it is similar to the very short-terms curren-

[70] On the very short-term financing: Part A No 3.7 and 4 of the **Resolution of the European, Council of 5 Dec. 1978** and Arts. 6ff of the **Central Banks Agreement**, references above note 26. See also Carreau. note 45 at 414 and Rey, Le **Rôle des Autorités monétaires au Niveau Européen** in: J. -P. ABRAHAM & M. VANDEN ABEELE (eds.), EUROPEAN MONETARY SYSTEM AND INTERNATIONAL MONETARY REFORM 233-256 at 234ff (1981).

[71] The VSTF has been inspired by a special arrangement between the Belgian franc and the Dutch guilder set up even before, see Rey **ibid.** at 234.

[72]Hahn, **Das Europaeische Waehrungssystem,** 14 EUROPARECHT 337-358 at 355 (1979). On the IMF reserve tranche financing see K. Dam, **The Rules of the Game** 118f (1982) with references.

cy support of the IMF within the reserve tranche.[72] Contrary to the other credit mechanisms the VSTF is reserved to the states tarticipating in the EMS, whether they are members of the EEC or not.[73]

B. Short-term monetary support (STMS)[74]

The short-terms monetary support is the oldest credit facility in the framework of the Community. It resulted from the Barre plan[75] as a reaction to the perturbation of the French franc in 1968. Its purpose is to mobilize common solidarity to counteract balance of payments difficulties. In this it fulfills the same function as the credit facilities of the IMF.[76] The decision whether support is needed is made by the central banks. which are the parties to the agreement. The mechanism of short-term monetary support underwent no change since its creation in 1970. Only the amounts of credits available and their duration have been increased under the EMS.[77] In its limitation by amount the STMS of the European Monetary System resembles the short-time financing within the reserve tranche of the IMF.[78]

C. Medium-term financial assistance[79] (MTFA)

The medium-term financial assistance resulted from the

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[73] Under the snake Norway and Sweden were beneficiaries of the VSTF. The United Kingdom on the contrary, a member of the EEC, has no access to VSTF not taking part in the EMS.

[74] On short-term monetary support: Carreau, n. 45 at 414f; Rey n. 70 at 236ff; Micklinghoff, **Les Grands Traits du Système Monétaire Européen,** 237 REVUE DU MARCHE COMMUN 250-257 (1980).

[75] above p. 4.

[76] Comp. K. Dam, **The Rules of the Game** 118ff (1982) and Silard, **The Role of the International Monetary Fund,** 32 THE AMERICAN UNIVERSITY LAW REVIEW 89-102 at 94ff (1982) on the IMF.

[77] Credits can now be given for a period of nine months maximum instead of six. For details, also on the determination of credit available, see Part A No 4.2, 4.3, 6.4 of the **Resolution of the European Council of 5 Dec. 1978,** ref. n. 26.

[78] Hahn, **Das Europaeische Waehrungssystem,** 14 EUROPARECHT 337-358 at 355 (1979).

[79] On medium-term financial assistance, see Carreau, n. 45 at 415; Rey, n. 70 at 238f Micklinghoff, n. 74 at 255f.

Barre plan[80] too and entered into force on March 22, 1971. It has a basis in Arts. 103 ff of the EEC Treaty, especially Art. 108 par. 2, which states:

> "... Mutual assistance may take the form, in particular, of: ....
>
> ....
>
> c) the granting of limited credits by other Member States, subject to the agreement of the latter..."

Like the short-term monetary support the cemanism underwent no major change since its creation; only the creditlines have been increased.[81] The medium-term financial assistance differs from the STMS by its duration (2 to 5 years), its governmental and conditional character and also by the lack of a prior determination of the individual drawing rights of each country. Medium-term financial assistance is given on ground of a procedure which involves the following steps: consultation of the Monetary Committee, a recommendation by the Commission and a qualified majority vote by the Council.[82] Assistance is conditional, with a borrower country having to agree to certain economic and monetary conditions. That reminds of the facilities within the credit tranche and of the standy-by agreements of the IMF, which are to remedy medium-term balance of payments difficulties on a universal plane.[83] The IMF has sometimes worked out rather restrictive commitments having important economic as well as social effects in countries forced by balances of payments crises to turn to the Fund.[84] That might result from the Council of Administration, a technical

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[80] p. 4.

[81] The overall credit ceiling has been increased from an amount of 5.450 to 14.1000 million ECU in 1978.

[82] Art. 108 par. 1 and 2 EEC Treaty.

[83] Hahn, **Das Europaeische Waehrungssystem,** 14 EUROPARECHT 337-358 at 357 comments on the similarity. On the credit tranche and stand-by agreements of the IMF, see K. Dam, **The Rules of the Game** 120-127 (1982); Silard, **The Role of the International Monetary Fund,** 32 THE AMERICAN UNIVERSITY LAW REVIEW 89-102 at 94-98 (1982) and further J. Gold, **The Legal Character of the Fund's Stand-By Agreements and Why It Matters,** 35 IMF PAMPHLET SERIES 53p. (1980).

[84] Comp. Dam **ibid.** at 125.

organ, deciding on the conditions. In the EMS on the contrary a political organ, the Council of the Communities, decides on the incumbencies of the countries borrowing.[85]

Another difference between EMS and IMF medium-terms assistance is that, unlike under the IMF, there is no individual ceiling on the individual drawing rights in the EMS. Moreover MTFA is regularly financed by the EMS member states except the beneficiary in proportion to their quotas, whereas the IMF sets up periodically the budget of the currencies to be drawn.[86]

Until now only the very short-term financing has become a procedure firmly established in practice. Both, the short-term monetary support and the medium-term financial assistance have each been resorted to only once.[87]

D. Mechanisms of assistance

1. Measures in favor of the less prosperous countries of the Community[88]

This mechanism has been newly introduced by the Resolution of the European Council establishing the European Mone-

[85] De Vries sees the technical body of the IMF deciding on medium-term credits as a model for further development of the EMS. He explains the disadvantages of the competence of the national Ministers of Finance under the present European system. See T.de Vries, **On the Meaning and the Future of the European Monetary System,** 138 ESSAYS IN INTERNATIONAL FINANCE 36 (1980) and below 28.

[86] Because the EMS members are suppliers and demanders at the same time, the ressources of the system run down to the extent drawings increase. To assure the necessary financing to a country in balance of payments difficulties, the Community therefore has concluded a stand-by agreement with the Bank of International Settlement. For further explanation see Hahn, **Das Europaeische Waehrungssystem,** 14 EUROPARECHT 337-358 at 356 (1979).

[87] Both operations involve transactions with the central bank of Italy in 1974. The short-term monetary support was given following a stand-by agreement with the IMF. Below 32.

[88] Read Part B of the **Resolution of the European Council of 5 Dec. 1978** reproduced as an annex. Also: Carreau, **Vers une Zone de Stabilité Monétaire,** 229 REVUE DU MARCHE COMMUN 399-417 at 415f (1979); Rey, note 70 at 239f and Micklinghoff, **Les Grands Traits du Système Monétaire Européen,** 237 REVUE DU MARCHE COMMUN 256-257 at 256 (1980).

tary System. It meets the basic concept that the durability of the system depends on the convergence of member states' economic performances. The states participating are primarily responsible themselves for achieving economic convergence by the coordination of their policies. But the Community has a supporting function. In this framework "steps are taken to strengthen the economic potential of the less prosperous countries of the Community".[89]

The measures in favor of the less prosperous countries are another emanation of the concept of a "Europe at several speeds".[90] They are an exception to the principle of uniformity. This principle requires an equal footing for all countries participating and underlies both international organizations, the European Community and the IMF.[91]

The operations include the granting of 3 percent interest rate subsidies for loans made available to the less prosperous countries by the Community institutions and by the European Investment Bank.[92] Loans are given for a five year period and under special conditions, and the costs caused by a loan to the Community must not exceed 1000 million ECU annually. Only member countries which subsequently effectively and fully participate in the EMS have access to the facility, the latter thus becoming an enticement to join the system. The measures in favor of less prosperous member states are a conditional facility. They are linked to the financing of selected infrastructure projects and programmes, on the understanding that any direct or indirect distortion of the competitive position of specific industries will have to be avoided.

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[89] No 2 of the **Council Resolution, ibid.**

[90] pp. 7/7 and 23/24

[91] On a 'Europe at different speeds", see Carreau, n. 88. On uniformity within the IMF, see K. Dam, **The Rules of the Game** 85-87 and also 127 (1982).

[92] Community loans are performed using the "Ortoli facility". For this financial instrument see **Decision of the Council of 16 Oct. 1978** in: JOURNAL OFFICIEL DES COMMUNAUTES EUROPEENNES L 298 (25 Oct. 1978).

[93] Until now loans have been granted to Italy and Ireland in 1976 and 1977.

2. Community loans

The mechanism of Community loans has been created in 1975 and expanded considerably in 1981. The loans mainly serve to recycle oil funds. They meet the requirement of uniformity to the extent that they are open to any member country, as a rule. The precondition for eligibility is that a member state faces balance of payments difficulties caused by the higher prices of oil. De facto the loans favor the less prosperous countries. Both in regard to their effect on the principle of uniformity and to their purpose to compensate distortions of the monetary ofder following oil crises the Community loans resemble the oil facilities of the IMF.[94] Also both facilities imply a double financial transaction: The IMF or the Community borrow and then lend the borrowed funds.[95] In comparison with direct borrowing in the market the state borrowing can expect a financial advantage because the international organization intervenes as a primary debtor. On the other hand the state is under the burden to fulfil conditions imposed in connec tion with the loan.[96]

IV. Prospects and conclusions

The EMS, as it presently functions, has only reached its first phase. There is a second phase envisaged in the Council's Resolution implying the creation of a European Monetary Fund

[94] On the oil facilities of the IMF: E. Wagenhoefer, **Unsere Internationalen Waehrungsbeziehungen** 60 (1982). They are also mentioned by Silard, **The Role of the IMF**, 32 THE AMERICAN UNIVERSITY LAW REVIEW 89-102 at 94 (1982).

[95] In the case of the IMF the oil facilities have been financed by credits of 17 countries, many of them oil exporting but also industrial countries. The Community resorts to the capital market.

[96] As the measures in favor of the less prosperous countries, the Community loans and the oil facilities of the IMF are given under conditions of economic policy to be fulfilled by the receiving state. In the case of the IMF conditions imposed have not been very strict. The Fund merely had to consider as appropriate the measures envisaged by the country; the country itself had to endeavor to save oil and to develop alternative energy sources. Comp. E. Wagenhoefer, **Unsere Internationalen Wirtschaftsbeziehungen** 60 (1982).

and the full use of the ECU as a reserve asset and a means of settlement.[97] The EMS under the impact of a new institution, the EMF is the subject of the following section. The international implications of the EMS will be dealt wilth afterwards.

A. The possible extension of the system

1. The future European Monetary Fund (EMF)

a. The present EMCF

The future European Monetary Fund will replace the present European Monetary Cooperation Fund (EMCF).[98] The EMCF has been created in 1973 and is not provided with an own organization. Its steering board, the Council of Administration, is identical in its composition with the Committee of the Presidents of the central banks of the EEC. Its agent is the Bank for International Settlement. The competences of the EMCF are confined to technical and legal matters. It is basically a clearinghouse. European monetary policy still lays with other organs and with the national central banks closely cooperating respectively.

b. The functions of the future EMF

The Resolution of the European Council mentions that the "system will entail the creation of the European Monetary Fund",[99] but only vaguely hints at how this Fund would have to be like. The establishment of the EMF, however, could most relevantly complete the EMS in regard to the exchange rate

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[97] Part A No 1.4 **Res. of the European Council of 5 Dec. 1978**, see annex.

[98] On the EMCF: E. Wagenhoefer, **Unsere Internationalen Wirtschaftsbeziehungen** 79 (1982); for a detailed description of the functions of the Fund see the Section **Economic and Monetary Policy** in the **Final Communique of the Conference of the Heads or Government** of Oct. 19-21, 1972 at Paris.

[99] Part A No. 1.4. On the EMF, see de Vries, **On the Meaning and Future of the European Monetary System**, 138 ESSAYS IN INTERNATIONAL FINANCE 25ff (1980) and Polak, The EMF: **External Relations**, BANCA NAZIONALE DEL LAVORO QUARTERLY REVIEW 359ff (Sept. 1980).

system and could help to promote economic convergence using the mechanisms of credit and assistance more effectively.

There are factors having a strong impact on the European currencies from outside the system, which are not yet handled appropriately. In the main states have to work out a common policy towards the US dollar. It is difficult to maintain a common standpoint without an institutional framework, but only the several finance ministers at hand, who are often caught up with their national interests. Under the snake arrangement, which also has been called a "German mark area", common floating against the dollar was achieved by pegging the other currencies on the German mark. The Federal Republic then overtook the external monetary leadership, i.e. the dollar policy.[100] As opposed to the snake there is no more one clearly economically leading state under the EMS, which could be assigned the task of externally steering the currencies. Filling this gap would be a most important function for the new EMF.[101]

The EMF would also concentrate credit and assistance mechanisms upon itself thereby streamlining the system. More important, a more effective use of the technique of conditionality could be expected and by that way a move towards convergence of national economic performances. The experts of the EMF would set up the conditions imposed on countries in difficulties. The staaf of the EMF would replace the diplomatically careful ministers of finances, who are predominantly influenced by national interests.[102] This change would bring the EMF nearer to the IMF-system.[103]

c.Some legal problems

But the creation of the EMF would also raise some legal problems, both on the national and the international plane.

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[100] On the "German mark area" and how the snake floated against the dollar: K. Dam, **The Rules of the Game** 329 (1982).

[101] Comp. T.de Vries, **On the Meaning and the Future of the European Monetary System**, 138 ESSAYS IN INTERNATIONAL FINANCE 33 (1980).

[102] On that problem de Vries, **ibid.** at 27, 35 and particularly 36.

[103] above p. 22.

On the national plane states participating grant the independence of their central banks.[104] That independence would be questioned, if the EMF could intervene deciding f.i. on liquidity and the external value of national currencies. Amendments of national laws might become necessary. However, that should pose no problem. The reason behind the rules on the independence of central banks is the principle of the separation between the money-creating and the spending power, i.e. the government. That way the pressures on governments from various sides to increase spending are to be mediatized. The creation of the EMF would bring about exactly such a clear separation between the monetary authority of the Community, the EMF, and the political powers within that Community, i.e. the national governments, the Council and the European Commission. The EMF would have the character of an embryonic European central bank.[105]

On the international plane Arts. 235 and 236 of the EEC Treaty come into play.[106] Art. 235, enactment of provisions by

[104] The central bank of the Federal Republic of Germany enjoys a rather extended independence as compared internationally, that has to be seen against the background of governmental war financing under the Hitler regime. The independence of the "Bundesbank" is laid down in Art. 88 as amended of the German Constitution and in paragraph 12 of the Statute on the Federal Bank ("Bundesbank-ggesetz") (1967).

[105] De Vries, n. 101 at 29, uses the necessary separation between the government and the money- creating power of the central bank as an argument for the creation of the EMF. Pursuant to the logic of the Treaty of Rome the European Commission should in time be transformed into a European federal government.

[106] Arts. 235, 236 of the EEC Treaty read as follows:

Article 235

"If any action by the Community appears necessary to achieve, in the functioning of the Common Market, one of the Community cases where this Treaty has not provided for the requisite powers of action, the Council, acting by means of a unanimous vote on a proposal of the Commission and after the Assembly has been consulted, shall enact the appropriate provisions.

Article 236

The Government of any Member State or the Commission may submit to the Council proposals for the revision of this Treaty.

the Council for unforeseen cases, has been a sufficient legal basis for the present EMS. The creation of the European Monetary Fund, however, implying a fargoing transfer of national responsibilities to a new Community institution would be an amendment to the Treaty of Rome. The treaty amending procedure of Art. 236 would apply. Ratification by the national parliaments would be required. That would also bring about the appropriate publicity and discussion within member states to a step of such paramount importance within the history of the integration of Europe.

Whether these hurdles on the national and international plane will be taken and the EMF established soon depends on the political will of the countries concerned.

2. The full use of the ECU

Another characteristic of the European Monetary System as envisaged in the Council Resolution is the "full use of the ECU as a reserve asset and a means of settlement"; the ECU "will be at the center of the EMF" (No. 1.4 and 2.1). Several questions arise.[107]

a. The first one relates to direct intervention in ECUs. Exchange rate management and the mechanisms of credit and assistance being centralized on the EMF the ECU at its center

means, that interventions would take place in ECUs. Thus, as central banks, the EMF would have the power to create liquidity. Liquidity creation by the Fund would replace the liquidity

If the Council, after consulting the Assembly and, where appropriate, the Commission, expresses an opinion in favour of the calling of a conference of representatives of the Governments of Member States, such conference be convened by the President of the Council for the purpose of determining in common agreement the amendments to be made to this Treaty.
Such amendments shall enter into force after being ratified by all Member States in accordance with their respective constitutional rules."

[107] The following explanations are based on T.de Vries, **On the Meaning and the Future of the European Monetary System**, 138 ESSAYS IN INTERNATIONAL FINANCE 29-31 (1980).

creation that occurs at present when bilateral credits are financed by national central banks. The problem is how to limit this liquidity creation by the Fund. At present there are the creditor limits. That system could be maintained by having the EMF purchasing debtor currencies and sell creditor currencies in IMF fashion. This procedure, however, would contradict the ECU being "at the center of the EMF". Another way to maintain creditor limits would be to establish acceptance limits for ECUs similar to those for the SDRs of the International Monetary Fund.[108] But again that would prejudice the full use of the ECU. The solution to the problem is a sound credit policy by the Fund with a strict control over the total issue of ECUs and an effective conditioning to hinder the accumulation and imbalances of ECUs.

b. Another issue is the use of ECUs in the private sector.[109] The ECU has the advantage of being a neutral currency within private international transactions between members of the EMS. As compared to the US dollar it would imply a lower exchange risk. The development of the ECU into a genuine European currency, used for both official and private transactions within the territory of the Community, would be a paramount achievement in European integration - a long-terms objective.

c. Finally one can wonder, whether ECUs should be promoted as a reserve asset for the monetary authorities of non-member countries too. The reserve currency systems based on the dollar and the pound sterling worked out quite unstable and produced strong pressure on these currencies. It is doubtful whether an ECU/dollar based system would prove more successful. Also since the EEC member countries reject their national currencies as becoming international reserve assets, it is con-

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[108] On acceptance limits for SDRs K. Dam, **The Rules of the Game** 153ff (1982). See also Art. XIX of the Arts. of Agreement of the IMF.

[109] On ECUs in the private sector, see-in detail-Thygesen, **Problems for the European Currency Unit in the Private Sector**, 3 THE WORLD ECONOMY 235-265 (1980); also: Guimbretière, **Le Marché de l'ECU**, 259 REVUE DU MARCHE COMMUN 388-395 (1982) and **Les Conditions d'un Marché de l'ECU**, 261 RMC 529-543 (1982). The ECU in the market involves the problem of a parallel currency, Thygesen, **ibid.** 255-260.

sequent having the same attitude towards their common currency, the ECU, too.

B. The EMS and international monetary order[110]

The EMS is fully compatible with the rules of the International Monetary Fund. As a zone of monetary stability it meets the purposes of the IMF as defined in Art. 1 of its Articles of Agreement "to promote exchange stability, to maintain orderly exchange arrangements among members and to avoid competitive exchange depreciation". Art. IV sect. 2 (b) of the Arts. of Agreement as amended expressly recognizes that the member countries of the IMF may adopt "cooperative arrangements by which members maintain the value of their currencies in relation to the value of the currency or currencies of other members". Also participating countries have been notifying the Fund on the creation of and changes within the EMS pursuant to Art. IV sect. 1 of the Arts. of Agreement. Member states of the EMS continue to be subject to the surveillance of the IMF as all other states. No problem as to the coexistence of the two systems should therefore arise. On the contrary the common history of the two institutions already shows an example of useful cooperation. In 1974 the Europeans took over the conditions set up by the IMF for a medium-term financial assistance to Italy. In regard to conditionality the EMS can draw from the experience of the Fund.

Moreover the ECU does not compete with the SDR. The ECU is conceived as a regional asset in the framework of the unification of Europe. This concept of at the same time aiming at more than just finances, a unified Europe, and being geographically restricted distinguishes the ECU from the SDR. Finally it should be mentioned that the EMS did not bring that much of an innovation to the international monetary order. The occurrence of generalized floating of currencies in 1973 did not result in independent and individual floating on the part of all member countries of the IMF. Rather it led to the appearance

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110 Comp. de Vries, n. 107 at 39-43 and Baquiast, **The European Monetary System and International Monetary Relations** in THE EUROPEAN MONETARY SYSTEM: ITS PROMIS AND PROSPECTS (P. H. TREZISE, ed.) 49-57 at 53ff (1979).

of several zones, within which exchange relations are more or less organized or stabilized. The EMS is only one of those zones.[111]

Conclusions

The EMS has a major potential for development. But it cannot and must not try to become a quasi-autarcic entity in the world. The importance of external factors is present in its dependence of the external value of the US dollar. In addition to the internal convergence of economic performances, which implies a similar setting of political priorities, the coordination of external economic policies is therefore paramount. That presupposes a strong political will for homogenization, since there are no preestablished procedures.[112] Also the transgression of the present EMS into its second phase will require considerable sacrifices as to national sovereignty. The repartition of a small territory like Europe in so many monetary and economic entities is an anomaly in today's industrialized world. The success of the EMS as of the integration of Europe depends on whether the decision makers are aware of that.

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[111] Baquiast, **ibid.**, 56, mentions the following floating zones: the dollar area, the SDR area, the European snake, the yen, the Swiss franc.

[112] This political will was put to a severe test in the framework of the exchangerate adjustment between France and Germany in April 1983.

ANNEX

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

A. The European Monetary System

1. INTRODUCTION

1.1 In Bremen we discussed a 'scheme for the cretion 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.'

1.2 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.

1.3 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.

1.4 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 European Council meeting at Bremen on 6 and 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

2.1 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 at the outset of the system.

2.2 The ECU will be used:

(a) as the denominotor (numeraire) for the exchange rate mechanism;

(b) as the basis for a divergence indicator;

(c) as the denominotor for operations in both the intervention and the credit mechanisms;

(d) as a means of settlement between monetary authorities of the European Community.

2.3 The weights 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 of, on request, if the weight of any currency has changed by 25 %.

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

3. THE EXCHANGE RATE AND INTERVENTION MECHANISMS

3.1 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 $\pm$ 2.25% will be established. EEC countries with presently floating currencies may opt for wider margins up to $\pm$ 6% at the outset of the EMS; these margins should be gradually reduced as soon as economic conditions permit.

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

3.2 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.

3.3 In principle, interventions will be made in participating currencies.

3.4 Intervention in participating currencies is compulsory when the intervention points defined by the fluctuation margins are reached.

3.5 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% 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 of reaching the threshold.

3.6 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.

3.7 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 three months for amounts limited to the size of debtor quotas in the Short-Term Monetary Support.

3.8 To serve as a means of settlement, an initial supply of ECUs will be provided by the EMCF against the deposit of 20% of gold and 20% 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% of these reserves with the 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

4.1 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.

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

Short-Term Monetary Assistance = ECU 14 billion;
Medium-Term Financial Assistance = ECU 11 billion.

4.3 The duration of the Short-Term Monetary Support will be extended for another three months on the same conditions as the first extension.

4.4 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

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

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

Participation will be based upon agreements central banks; these agreements will be communicated to the Council and the Commission of the European Communities.

5.3 The EMS is and will remain full compatible with the relevant articles of the IMF Agreement.

6. FURTHER PROCEDURE

6.1 To implement the decisions 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 EMCF, which introduces the ECU in the operations of the EMCF 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 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.

6.2 It requests the Commission to submit in good time a proposal to amend the Council Decision of 22 March 1971 on setting up machinery for medium-term financial assistance to enable the Council (Economics and Finance Ministers) to take a decision on such a proposal at their session of 18 December 1978.

6.3 It requests the central banks of Member States to modify their Agreement of 10 April 1972 on the narrowing of margins of fluctuation between the currencies of Member States in accordance with the rules set forth above (see Section 3).

6.4 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 ECU 7.9 billion.

(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 ECU 15.8 billion.

(c) The total of the additional creditor amounts as well as the total of the additional debtor amounts may not exceed ECU 8.8 billion.

(d) The duration of credit under the extended Short-Term Monetary Support may be prolonged twice for a period of three months.

B. Measures designed to strengthen the economies of the less prosperous Member States of the European Monetary System

1. We stress that, within the context of a broadly based strategy aimed at improving the prospects of economic development and based on symmetical 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 (Economics and Finance Ministers) to strengthen its procedures for cooperation in order to improve that convergence.

2. 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.

3. The European Council agrees that in the context of the European Monetary System, the following measures in favour of less prosperous Member States effectively and full participating in the exehange rate and intervention mechanisms will be taken.

3.1 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 five years loans of up to EUA 1 billion per year to these countries on special conditions.

3.2 The European Council requests the Commission to submit a proposal to provide interest rate subsidies of 37 for these loans, with the following element: the total cost of this measure, divided into annual tranches of EUA 200 million cach over a period of five years, shall not exceed EUA 1 billion.

3.3 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 full in the mechanisms will not contribute to the financing of the scheme.

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

3.5 The European Council requests the Council (Economies 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.

4. 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 runds which aim at reducing structural imbalances. The results of these studies will be discussed at the next European Council meeting.