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COUNCIL AND COMMISSION

TWENTIETH REPORT
ON THE ACTIVITIES OF THE MONETARY COMMITTEE

FOREWORD

The purpose of this report is to give a brief account of the activities of the Monetary Committee in the course of 1978.

During the year, the Committee held 11 sessions and the working parties drawn from its own members or set up at its initiative met on many occasions.

At its session of 9 December 1977 it had elected its officers. It elected as chairman Mr J. van Ypersele de Strihou, Office of the Prime Minister, Brussels, and as vice-chairmen, Mr S. Andersen, Joint-Governor of Danmarks Nationalbank, Mr N. Jordan-Moss, HM Treasury, London and Mr P. Jaans, Banking Control Commission, Luxembourg. The terms of office of the new members will expire on 31 December 1979. A list of members as at 31 December 1978 is annexed.

At its meeting of 5 and 6 June it celebrated the twentieth anniversary of its first meeting, held on 4 June 1958. To celebrate this occasion, the present chairman, Mr van Ypersele, invited the Committee and its former chairmen and vice-chairmen to a reception held on 5 June 1978. The written contributions of the former chairmen, and the speech given by the present chairman are collected in a small brochure entitled 'Twenty years of the Monetary Committee', which is available on request from the Committee's Secretariat.

The report was adopted as at 31 December 1978.

INTRODUCTION

1. The expansion of world economic activity continued to be moderate in 1978. Growth rates both of production and world trade were similar to those of 1977. The structure of balances of payments altered greatly: on the one hand, the OPEC surplus fell markedly, and the deficit of the non-oil producing developing countries increased and, on the other hand, the OECD countries went back into surplus. Among these latter, developments were not homogeneous: the United States' deficit worsened further, but was more than compensated by the improvement in the balances of other countries, particularly the Community and Japan.

2. The economic situation in the Community again presented rather a contrast in 1978. On the one hand,

the results for growth and employment were deceptive: growth of output remained mediocre, barely above the level of 1977, and unemployment continued to increase throughout most of the year. On the other hand, further progress was achieved on prices and external payments: the slow-down in the rate of inflation continued, and was particularly marked in those countries where it has been highest; similarly, there was a substantial increase in the Community's current account surplus, and this movement, which is primarily due to the improvement in the terms of trade, was particularly marked in a number of countries which had been in a relatively weak position in previous years.

COMMUNITY ACTION AND THE ACTIVITIES OF THE COMMITTEE

3. 1978 was a significant year for the Committee, which played a vital role in the preparation and development of the European monetary system, and during the second half of the year devoted its time almost exclusively to this question.

4. On 17 November 1977 the Commission presented a communication to the European Council of 4 and 5 December 1977 on the prospects of economic and monetary union, and at its meeting of 19 December 1977, the Council had requested the Committee, along with the Economic Policy Committee and the Committee of Governors, to examine this communication. To this end, the alternates met on several occasions and submitted a report to the Committee at its meeting of 4 April 1978, who then held an exchange of views on this subject.

5. On 6 and 7 April 1978 the European Council met in Copenhagen, and the conclusions of the Presidency set out a list of objectives relating to the economic and social situation. In particular, it stated:

'2. The European Council has examined the need for increased monetary stability both in the Community and at world level.'

It requested the Council to take the necessary measures to achieve these objectives.

The Council therefore, at its meeting of 17 April 1978, requested the Monetary Committee and the Committee of Governors to continue their work on the monetary problems in the Community and to report back in May or June.

6. In response to this request, at its meeting of 11 and 12 May, the Committee held a wide-ranging and detailed exchange of views on ways of promoting greater stability in exchange rate relationships between EC member countries. This examination was based on the following assumptions about any new exchange rate system:

(a) It would be applicable to all Community currencies.

(b) It would be symmetrical with regard to the burden of adjustment.

(c) It would be supported by substantial credit facilities.

The chairman presented an oral statement to the Council of 22 May which summarized the Committee's conclusions to date.

7. At its meeting of 5 and 6 June the Committee continued its examination and drew up a report to the Council and the Commission which contained the so-called 'three variants', which were in fact, sets of variants, for achieving exchange rate stability. These were, in essence:

(a) The 'strict' variant, involving obligations to defend a nominal market rate *vis-à-vis* each partner currency. Two alternatives were envisaged here. Firstly, the re-entry of all member currencies into 'the snake', but with an element of flexibility in the form of a transitional period during which wider margins or a flexible procedure for changing central rates could be applied. Secondly, a similar new system could be created, but with additional features such as a simplified procedure for small changes in central rates, provision for temporary leave of absence and elements of a common attitude to major third currencies.

(b) The 'weighted index' variant, whereby intervention obligations would be defined by reference to a weighted index, constructed either on the basis of the European unit of account (EUA) or effective exchange rates (weighted according to the geographical distribution of foreign trade). Participating countries would commit themselves to maintaining the index within a given margin.

(c) The 'flexible' variant, involving a system of concerted fluctuations represented by a 'reference zone' for the three currencies which were floating individually and 'the snake' as a whole. There were no commitments to defend margins, the only obligations being: firstly, to abstain from measures likely to cause the exchange rate to move out of its reference zone and, secondly, for countries to submit to a consultation procedure which would be triggered automatically if the reference zones were breached or abandoned.

8. On 6 and 7 July the European Council met in Bremen and examined a proposal for the creation of closer monetary cooperation (through the setting up of a European monetary system) leading to a zone of monetary stability in Europe. The main principles of the EMS were laid down in the Annex to the conclusions of the Presidency, known as 'the Bremen Annex'.

9. The Committee was requested by the Finance Council of 24 July 1978 to examine the system set out in the Bremen Annex and report back to the Council of 18 September. After three meetings of the alternates and two meetings of the Committee, on 7 September 1978 it adopted an interim report on the European monetary system, which dealt essentially with the problems linked to the *numéraire* — such as the definition of central rates and margins, the characteristics of the various systems (parity grid and basket systems) and changes in central rates — and interventions — such as intervention currencies, width of margins, and symmetry of intervention obligations — and which also contained preliminary considerations on the European Monetary Fund (EMF).

10. This report was considered by the Council at its meeting of 18 September, which requested the relevant Committees to continue their work in the light of the discussions which had taken place in the Council. Following preparation by the alternates, on 12 October 1978, the Committee adopted a report on the European monetary system, which carried further the examination in its interim report, in particular, on the assumption that the EMS would be based on a combined use of the 'parity-grid' formula and the 'ECU basket' formula, the latter being used to determine the 'degree of divergence' of participating currencies.

11. This report was examined by the Council at its meeting of 16 October, which concentrated its discussion on the intervention rules and the strengthening of credit mechanisms and requested the Committees to continue their work and clarify certain outstanding matters.

12. On 7 November the Committee adopted its final report to the Council and the Commission on the European monetary system (Annex I) after a long discussion of the questions still pending.

This report was examined by the Council on 20 November and on the basis of this report, that of the Committee of Governors and that of the Economic Policy Committee, the Presidency of the Council prepared an overall report to the European Council.

13. The European Council met on 4 and 5 December and adopted a resolution on the establishment of the European monetary system (EMS), which was to begin on 1 January 1979.

The Committee is aware that the lasting success of the EMS requires an improvement in coordination of national economic policies and it is prepared to make, within the existing framework, its contribution to secure an improved convergence of economic policies between Member States as set out in its report to Council and the Commission of 28 February 1978 (Annex II).

14. As in previous years the Committee carried out regular examinations of the economic situations in Member States, with particular reference to monetary and exchange rate policy, and the use of monetary targets as stated in its report of November 1976 (see nineteenth annual report, paragraphs 8 to 10). In the framework of these examinations, the Committee discussed in particular the policies pursued by France, Germany and the United Kingdom.

15. In addition, as required by the Council Decisions granting financial aid by the Community to Italy and Ireland, the Committee was consulted on the situation of these countries. In January the Committee took note of a report prepared by the *ad hoc* Working Party chaired by Mr de la Genière, which presented an analysis of the economic situation in Italy in 1977. In May the *ad hoc* Working Party again presented a report to the Committee, and the Committee adopted a report to the Council and the Commission. Finally, another report to the Council and the Commission was approved by the Committee at its meeting of 18 and 19 July 1978 fixing the fundamental and 'instrumental' objectives for 1978 and the fundamental objectives for 1979.

16. In February the Committee adopted a report drafted by the *ad hoc* Working Party chaired by Mr Andersen on the economic situation in Ireland, prospects for 1978 and the respect of the economic

policy conditions in 1977, which was submitted to the Commission for information.

17. The Committee also devoted a significant proportion of its time to international monetary questions, in preparation for the interim Committee meetings in April and September and the annual meeting of the International Monetary Fund in September.

The two principal questions with which the Committee had to deal this year were the SDR (new allocation, improvement of the characteristics — valuation, interest rate, reconstitution obligation — substitution account) and the review of quotas.

18. The Committee also examined various other matters, such as a proposal to amend the Community loan mechanism, a proposal for a draft Third Directive implementing Article 67 of the EEC Treaty (Annex III), a proposal for refinancing by the Bank for International Settlements of claims arising from the medium-term financial assistance mechanism, and several proposals to change the conversion rates for national currencies into units of account for the purposes of the common agricultural policy.

19. Finally, in the framework of the setting up of the EMS, the Committee considered the Commission proposals for Council Regulations changing the value of the unit of account used by the European Monetary Cooperation Fund; on the European monetary system; and on the impact of the European monetary system on the common agricultural policy, as well as a proposal for a Council Decision amending Decision 71/143/EEC setting up machinery for medium-term financial assistance. It also examined legal problems involved in the implementation of the EMS, on the basis of a report prepared by an *ad hoc* Working Party set up for this purpose.

WORKING PARTIES OF THE MONETARY COMMITTEE

20. The Working Party on Securities Markets met five times in 1978 and continued to examine developments in the capital markets of the Member States and in the international bond markets, and also discussed capital market policies.

At the request of the Monetary Committee it prepared a draft opinion on the proposal for a draft Third Directive for the implementation of Article 67 of the EEC Treaty, which the Monetary Committee adopted at its meeting of 5 and 6 June 1978 (see paragraph 18).

21. The Working Party on the Harmonization of Monetary Policy Instruments, a joint group of the Committee and the Committee of Governors, met several times in 1978. It continued its work on intermediate objectives, with a detailed study of the possible obstacles to their harmonization, and had almost completed this by the end of the year. This work should provide the corpus of a report which the Working Party intends to present to its parent Committees at the very beginning of 1979.

LIST OF MEMBERS AND ALTERNATES OF THE MONETARY COMMITTEE

Chairman

Mr J. van Ypersele de Strihou	Chef de Cabinet du Premier ministre (Brussels)

Vice-Chairmen

Mr S. Andersen	Gouverneur — Danmarks Nationalbank (Copenhagen)
Mr N. Jordan-Moss	HM Treasury (London)
Mr P. Jaans	Commissaire au contrôle des banques (Luxembourg)

Members

Mr M. J. Balfour	Bank of England (London)
Mr F. Boyer de la Giroday	Director in the Directorate-General for Economic and Financial Affairs — Commission of the European Communities (Brussels)
Mr J.-M. Camdessus (since 1 September 1978	Chef du service des affaires internationales à la direction du trésor, ministère de l'économie et des finances (Paris)
Mr R. de la Genière	Premier sous-gouverneur de la Banque de France (Paris)
Mr J.-Y. Haberer (until 31 August 1978	Chef du service des affaires internationales à la direction du trésor, ministère de l'économie et des finances (Paris)
Mr K. Hansen	Director general — Det Okonomiske Sekretariat (Copenhagen)
Mr M. Horgan	Department of Finance (Dublin)
Mr G. Janson	Directeur de la Banque nationale de Belgique (Brussels)
Mr R. Kirsch	Conseiller de gouvernement, ministère des finances (Luxembourg)
Prof. G. Magnifico	Banca d'Italia (Rome)
Dott. U. Mosca	Director-General for Economic and Financial Affairs — Commission of the European Communities (Brussels)
Mr T. O'Grady Walshe	Central Bank of Ireland (Dublin)
Dott. S. Palumbo	Dirigente generale al ministero del tesoro (Rome)
Mr K. O. Poehl	Vizepräsident der Deutschen Bundesbank (Frankfurt am Main)
Drs. A. Szasz	Directeur van de Nederlandsche Bank NV (Amsterdam)
Dr H. H. Weber	Ministerialdirektor — Bundesministerium der Finanzen (Bonn)
Dr A. H. E. M. Wellink	Thesaurier-generaal bij het Ministerie van Financiën (The Hague)

Chairman of the alternates of the Monetary Committee

Mr H. Baquiast	Sous-directeur à la direction du trésor, ministère de l'économie et des finances (Paris)

Alternates

Drs. D. H. Boot	Onderdirecteur van de Nederlandsche Bank NV (Amsterdam)
Mr P. J. Bull	Bank of England (London)
Mr H. Dalgaard	Kontorchef — Danmarks Nationalbank (Copenhagen)
Drs. F. A. Engering (since 1 June 1978)	Ministerie van Financiën (The Hague)
Dr W. Flandorffer	Ministerialrat, Bundesministerium für Wirtschaft (Bonn)
Mr M. Emerson (since 15 February 1978)	Director in the Directorate-General for Economic and Financial Affairs — Commission of the European Communities (Brussels)
Mrs M. Hedley-Miller	HM Treasury (London)
Mr G. Jennemann (until 3 January 1978)	Bankdirektor, Deutsche Bundesbank (Frankfurt am Main)

Mr G. Lefort	Directeur général des services étrangers de la Banque de France (Paris)
Dott. S. Masera	Banca d'Italia (Rome)
Mr D. McCutcheon (since 1 July 1978)	Department of Finance (Dublin)
Mr G. Reynolds	Central Bank of Ireland (Dublin)
Dr. W. Rieke (since 1 February 1978)	Deutsche Bundesbank (Frankfurt-am-Main)
Mr M. Schmit	Inspecteur des finances (Luxembourg)
Mr B. Scully (until 30 June 1978)	Department of Finance (Dublin)
Mr N. Ussing	Kommiteret — Det Okonomiske Sekretariat (Copenhagen)
Drs. R. van Boven (until 30 May 1978)	Ministerie van Financiën (The Hague)
Mr R. Vanden Branden (since 1 January 1978)	Chef du Service des accords internationaux de la Banque Nationale de Belgique (Brussels)
Mr J. Vanormelingen	Administration de la Trésorie (Brussels)
Dr M. Wegner (until 14 February 1978)	Director in the Directorate-General for Economic and Financial Affairs — Commission of the European Communities (Brussels)
Mr P. Zimmer	Commissariat au contrôle des banques (Luxembourg)
Dott. A. Zodda	Ministero del Tesoro (Rome)

Secretariat

Mr G. Morelli (until 30 May 1978)

Mr A. Kees (since 28 November 1978)

Mr G. Lermen

Mr A. Chapman

ANNEX I

FINAL REPORT TO THE COUNCIL AND THE COMMISSION ON THE EUROPEAN MONETARY SYSTEM

I. INTRODUCTION

1. In accordance with the request from the Council at its session of 16 October 1978, the Monetary Committee hereby submits its final report on the system, outlined in the summary of conclusions of the Presidency of the European Council on 6 and 7 July 1978 and the Annex thereto relating to the creation of closer monetary cooperation between all Member States.

2. The European Council envisaged a durable and effective scheme with a European currency unit (ECU) at its centre and with all the basic features of the system outlined from the outset. The Committee has examined a wide range of issues in the perspective of the final stage of a European monetary system (EMS), viz., the *numéraire*, intervention and the European Monetary Fund. As a period of up to two years has been provided for the establishment of the Fund in its final form, the examination of this was preliminary and only the transitional period has been treated in detail. It was

considered essential that as implied in the Bremen Annex, the exchange rate system and the appropriate credit facilities should come into being at the same time. The Committee draws attention to the fact that legal measures at Community, and possibly at national level, will be necessary before the entry into force of the system.

3. The EMS must be seen in the context of the range of policies needed to achieve a greater amount of convergence between the economies of the Member States and equally it cannot be durable and effective unless it is backed by complementary policies. As there are still important divergences in the situations of Member States it will need great effort on the part of all, both surplus and deficit countries, and in all areas of policy if the system is to be durable and effective. Countries must as a matter of principle give a high priority to internal policy measures rather than to exchange rate charges, otherwise the effectiveness of the system would be jeopardized. The associated questions of economic policy coordination have been dealt with by the Economic Policy Committee.

4. The functioning of the system outlined in the following paragraphs will require regular consultations between the competent authorities, including the Monetary Committee.

II. NUMÉRAIRE

A. DEFINITION AND USE OF ECU

5. The Annex to the Bremen Communiqué states that the ECU will be at the centre of the system.

6. The ECU, like the EUA, will be defined as a basket containing specific quantities of the Member States' currencies; but there will be a procedure for re-examining the weights. Some members suggested that the weights of the currencies in the ECU be examined before the start of the system. Others pointed out that this would create problems for its use in other Community sectors.

7.1. The Committee is of the opinion that a re-examination should take place every five years, or when the weight of any currency has changed by a significant amount, for example 25 %, either of which examination may or may not result in a revision.

7.2. It is agreed that any revisions must be mutually accepted, would be made in line with the underlying economic criteria and in such a way as not to change the external value of the ECU at the moment of revision. Also the process of revision should be carried out in such a way as to minimize any interference with decisions to change central rates.

8. The ECU will be used:

— as the *numéraire,* i.e. each currency will have a central rate against the ECU,

— as a divergence indicator,

— as a denominator of claims and liabilities arising from the intervention system,

— as a means of settlement between monetary authorities of the EEC.

B. CHANGES IN CENTRAL RATES

9. While the EMS itself ought to contribute to reducing divergences in economic performance, it should not prevent remaining real disparities from being reflected in exchange rates. There should therefore be sufficient flexibility in the system, and, in addition to an appropriate range of credit facilities (which would not themselves be a sufficient remedy in all circumstances), there should be arrangements for adjusting central rates by mutual agreement.

10. The credibility of the new system depends upon progressive convergence of economic performance, making reliance on exchange rate changes gradually less important. In the meantime, however, if they do become necessary, they should not be delayed to the point at which heavy speculative pressure builds up. They should be implemented as far as possible while the exchange markets are calm.

11. As regards the procedures to be established, it was observed that a set of economic and technical criteria implying automatic rules for central rate changes would have the advantage of rendering the decisions formally objective. But it would be impossible to devise a set of rules which removed the need for applying judgement, and even if it were possible, they would involve the risk of becoming known and of inviting speculation on the prospective realignment. Since this would not be a tenable course of action, changes in central rates should therefore be made by mutual agreement rather than fixed rules.

III. INTERVENTIONS

A. INTERVENTION OBLIGATIONS

12. The ECU central rates would be used to establish a grid of bilateral exchange rates around which fluctuation margins would be fixed by applying a given percentage margin. The resulting bilateral limits define the obligatory intervention points. These would be announced to the market.

13. The envisaged system would be based on a combined use of the parity grid and the ECU basket formula, the latter being used to determine 'the degree of divergence' of participating currencies in order to draw certain consequences for intervention rules, and/or other policies.

14.1. In this system, obligatory intervention would occur when the bilateral limits were attained. Action would also be taken by the monetary authorities as soon as a certain spread, measured in terms of ECU had been exceeded.

14.2. The use of the ECU mentioned above would be triggered by the attainment of a minimum spread (referred to as 'the threshold of divergence') between the central rate expressed in ECU and the rate of the day expressed in the same terms. This divergence threshold would be calculated for each currency in such a way as to eliminate the influence of disparities of weight on the probability of reaching the threshold. It would be established in such a manner that a currency could attain its divergence threshold before reaching its bilateral limit, but would not necessarily do so. The divergence threshold in ECU could be fixed at 75 % of its maximum spread for each currency.

14.3. If a currency crossed its divergence threshold, there is a presumption that action must be undertaken by the monetary authorities of the country concerned.

14.4. This action would initially consist of diversified interventions on the exchange market. The object of these diversified interventions would be both to check divergent trends and to alleviate the burden on currencies furthest removed from a divergent currency; this would allow a better distribution of intervention burdens. In the case of persistent divergence other more basic measures would have to be envisaged, in consultation.

More specifically, when a currency exceeded its divergence threshold, the central bank concerned would, in principle, be obliged to diversify its intervention practices:

(a) if the bilateral limit had not been reached, it would have to commence intervention, either in Community currencies (see (c) below) and/or in dollars, to check the divergent trend;

(b) if the bilateral limit had been reached, the obligation to intervene would be not only in the currency furthest removed from it but also, to alleviate the situation of that currency, in dollars or in other Community currencies close to their bilateral limit in the opposite direction (see (c) below);

(c) in order to facilitate the diversification of intervention, a central bank should not oppose stabilizing interventions in its currency, when its currency was relatively close to a bilateral intervention limit.

14.5. If a central bank did not take action in the manner indicated under (a) or (b) above, it would have to give reasons for failing to do so in the context of concertation arrangements; it would be required to indicate the whole range of monetary policy measures it intended to take. If a central bank as referred to under (c) above wanted to oppose intervention in its currency, then it would have to give reasons for doing so.

14.6. If, notwithstanding action under 14.4 (a) or (b) above, a currency still remained beyond its divergence threshold, the monetary authorities of the country concerned would be required to give an account of measures it intended to adopt to overcome this divergence. A common assessment of the situation would be made in the framework of consultations in the Monetary Committee. These consultation procedures should be reviewed periodically to ensure that they are operating effectively.

15.1. All members indicated that the arrangements outlined in paragraph 14 above could provide a basis for agreement, although this was subject to certain qualifications.

15.2. Firstly, since this system is in some respects more strict than the present 'snake', certain members indicated that they could agree as long as crossing the divergence threshold involved not only intervention by the divergent currency but also greater symmetry of obligations by deficit and surplus countries alike in general adjustment policies. They believe that if the currency of a creditor diverged, the credits resulting from the interventions of this central bank should be governed by special rules, more favourable to the debtor, in so far as the currency of this latter was in itself not divergent. Similarly, in cases where the consultation procedures set in train by the divergence of the currency of a deficit country had not led to satisfactory adjustment measures, that country's access to the short-term facility, at least in respect of the portion in excess of a specified amount, could be limited.

Some of these members also believe that, for the system to work, it would be necessary, at least in a transitional phase, to allow for wider bilateral margins for countries presently floating independently.

15.3. Secondly, other members, who are of the opinion that there should not be intervention obligations as soon as the divergence threshold is crossed, and who are not inclined to consider any necessity to disprove the presumption to intervene, are prepared to envisage the following procedure:

— The crossing of the divergence constitute a presumption to act to correct the situation. The actions to be taken will be discussed in the normal concertation procedure among central banks.

— If, after more than five days, the divergence remains, central banks will consult formally with each other to form a judgement whether one or several of the following measures appropriate to the situation should be taken:

  — further intervention,

  — monetary measures,

  — drawing on the credit facilities,

  — other external and domestic policy measures.

Measures beyond the competence of central banks concerned have to be referred to the appropriate authorities for immediate action.

16. Whatever the solution adopted for the role of the ECU as a divergence indicator it may be that intervention in third currencies is carried out even before bilateral intervention points are reached. A situation might also arise in which such interventions in third currencies would also be desirable to supplement obligatory interventions within the

EMS when the mandatory intervention points have been attained for instance so as to avoid imposing on the currency in opposition an excessive burden. Regardless of the currency chosen, these interventions should, in principle, be subject to prior consultation. There should be no automatic or binding rules for interventions in third currencies; in particular, any having the effect of pegging these currencies' exchange rates should be avoided.

B. WIDTH OF MARGINS

17. The present 'snake' margins of 2·25 % would in all cases remain unchanged for the currencies presently in that system.

More generally, there was broad support that the maximum spot margin between two currencies should be fixed at 2·25 % if the proposals of paragraph 14 were adopted.

18.1. However, certain members considered that the maximum spot margin should exceed 2·25 %. This would still be in conformity with the Bremen principle as interventions would normally take place before the bilateral margins are reached, because of the divergence indicator.

18.2. More specifically, according to these members, the Bremen principle could be satisfied by a combination of narrow ECU margins for all Community currencies and wide general bilateral spreads. The present 'snake' limits would remain fully intact for 'snake' members, but the ECU margins would be set in such a way as to be met, in general, before attainment of all bilateral limits, including those in 'the snake'. There would thus be two possible bands of fluctuation in the EMS.

19. Temporary suspension of defence of margins is to be seen as an emergency provision. It is a possibility of last resort. For a country to be able to have recourse to this procedure, there must be the assumption that the determining factors are of a temporary nature. A situation could arise, however, in which these factors were not reversed in which case a country would re-enter with a different central rate. There would be technical consequences if any currency temporarily ceased to defend its margins. One possible solution for dealing with such consequences might be to freeze the rate of that currency in the ECU.

C. RELATIONSHIPS WITH THE IMF

20. The system of intervention and the type of intervention obligations set up within the EMS would have to comply with the IMF Articles of Agreement, in particular as regards the new Article IV. The Community will supply the IMF with the appropriate information on the workings of the EMS.

IV. RELATIONS WITH THE ASSOCIATED COUNTRIES

21. The Annex to the Bremen Communiqué states that non-member States with particular close economic and financial ties with the Community may become associated members to the system. The central banks of these countries should be given the opportunity of participating in the European exchange rate system. Details of their participation would be negotiated with the central banks of the interested countries. In principle, they would be required to intervene in the same way, and would participate in coordination mechanisms. They would also have access to very short-term financing. Transactions between the associated central banks and the EMS could be recorded in accounts in the name of these banks, to be kept by the Fund. However, the associated central banks would not participate in short- and medium-term credit mechanisms, nor could their currencies be included in the composition of the ECU basket.

22. The precise nature of the links interested countries having close economic and financial ties with the Community would have to be considered by the appropriate Community bodies.

V. THE FUND (1)

23. The Committee has considered the Fund in the light of the following principles:

— An initial supply of ECU will be created against the deposit of US dollars and gold (for example, 20 % of the stock currently held by member central banks).

— A credit system based on a comparable sum of member currencies should be established.

— Not later than two years after the start of the scheme these arrangements will be consolidated in a single Fund.

24. The Committee has examined the problems of the transitional period with a view to the rapid implementation of the system.

Transitional period

A. CREDITS

25. During the transitional period before the setting up of the EMF in its final form, the credit mechanisms could be extended in the following way:

1. *The very short-term credit mechanism*

26. For settling balances within the Community it has been suggested by some members that it might be useful that

(1) In order to take account of the monetary situation of Luxembourg, when setting up the EMF, it will be necessary to adopt a formula, which assigns a separate quota to Luxembourg.