

**THE EUROPEAN COUNCIL**

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Documents in the dossier include:

*Conclusions*

Session of the European Council  
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*The European Council in Brussels—Outcome and follow-up*  
Reproduced from the Bulletin of the European Communities, No. 12/1978

*European Council Agrees to Establish Monetary System*  
European Community News No. 32/1978  
European Community Information Service  
Washington DC

*Economic Policy: European Monetary System*  
Mr. James Callaghan, Prime Minister, in the House of Commons on December 6, 1978  
British Information Service  
New York NY

## Session of the European Council

Brussels, 4 and 5 December 1978

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### Conclusions

The European Council agreed, on the basis of the preparatory work of the Council (Economics and Finance Ministers) and of the Monetary Committee and the Committee of the Governors of the Central Banks to set up a European Monetary System as from 1 January 1979. This agreement is enclosed as an Annex.

The purpose of the European Monetary System is to establish a greater measure of monetary stability in the Community. It should be seen as a fundamental component of a more comprehensive strategy aimed at lasting growth with stability, a progressive return to full employment, the harmonization of living standards and the lessening of regional disparities in the Community. The Monetary System will facilitate the convergence of economic development and give fresh impetus to the process of European Union. The Council expects the European Monetary System to have a stabilizing effect on international economic and monetary relations. It will therefore certainly be in the interests of the industrial and the developing countries alike.

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### The European Monetary System

#### 1. Introduction

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

- 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 creation of the European Monetary Fund as announced in the conclusions of 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 denominator (numéraire) for the exchange rate mechanism;
- (b) as the basis for a divergence indicator;
- (c) as the denominator for operations in both the intervention and the credit mechanism;
- (d) as a means of settlement between monetary authorities of the EC.

- 2.3 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.

### 3. The exchange rate and the intervention mechanism

- 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 2,25% will be established. EC countries with presently floating currencies may opt for wider margins up to 6% at the outset of EMS; these margins should be gradually reduced as soon as economic conditions permit to do so.

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

- 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 to reach 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 FECOM 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 FECOM. 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 25 000 million ECU of effectively available credit. The distribution of this amount will be as follows:
- Short-term monetary support = 14 000 million ECU
  - Medium-term financial assistance = 11 000 million ECU
- 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 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 mechanism.

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

5.3 EMS is and will remain fully compatible with the relevant Articles of the IMF Agreement.

## 6. Further procedure

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

- (a) Council Regulation modifying the unit of account used by the European Fund of Monetary Cooperation, 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 re-establish 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 the introduction of a mechanism for the medium-term financial support to enable the Council of Economics and Finance Ministers to take a decision on such proposal at their session of 18 December 1978.
- 6.3 It requests the central banks of Member States to modify their Agreement of 10 April 1972 on the reduction of margins of fluctuation between the currencies of Member States in accordance with the rules set forth above (see paragraph 3).
- 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 7,9 billion ECU.
  - (b) The total of creditor quotas made available by the central banks of Member States for financing the debtor quotas shall be increased to an aggregate amount of 15,8 billion ECU.
  - (c) The total of the additional creditor amount as well as the total of the additional debtor amount may not exceed 8,8 billion ECU.
  - (d) The duration of credit under the extended short-term monetary support may be prolonged twice for a period of three months.

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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 symmetrical rights and obligations of all participants, the most important concern should be to enhance the convergence of economic policies towards greater stability. We request the Council (Economic and Finance Ministers) to strengthen its procedures for coordination in order to improve that convergence.
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 the less prosperous Member States ef-

fectively and fully participating in the exchange 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 5 years loans of up to 1 000 million EUA 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 3% for these loans, with the following elements:

The total cost of this measure, divided into annual tranches of 200 million EUA each over a period of five years shall not exceed 1 000 million EUA.
  - 3.3 Any less prosperous Member State which subsequently effectively and fully participates in the mechanisms would have the right of access to this facility within the financial limits mentioned above. Member States not participating effectively and fully in the mechanisms will not contribute to the financing of the scheme.
  - 3.4 The funds thus provided are to be concentrated on the financing of selected infrastructure projects and programmes, with the understanding that any direct or indirect distortion of the competitive position of specific industries within Member States will have to be avoided.
  - 3.5 The European Council requests the Council (Economics and Finance Ministers) to take a decision on the abovementioned 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 Funds which aim at reducing structural imbalances. The results of these studies will be discussed at the next European Council.

## Economic and social situation

The European Council has reviewed the economic and social situation in the Member States of the Community. It notes with satisfaction that since its meeting in Bremen the conditions for strengthening the process of economic growth in Europe have improved.

The Heads of State and Government have reported on the measures they have introduced. The European Council deems it imperative, particularly in view of the disturbing employment situation, to ensure the further rapid implementation of these measures. It reaffirms its view that only a common coordinated approach by all Member States can lead to greater convergence of



economic development in the European Communities. The efforts of all Member States to reduce inflation must therefore be intensified in order to ensure the durability of the European Monetary System.

The European Council asked the Commission to provide for its second meeting in 1979 a study of structural development prospects until 1990. This study should assess the consequences of structural changes for the economic and social situation in the Community.

The European Council welcomed the decision of the Labour and Social Affairs Council to extend the Social Fund to assist recruitment and job creation schemes for young people. In view of its continuing concern about youth unemployment the European Council asked the Labour and Social Affairs Ministers to keep the working of the new aid under review.

### Tripartite Conference

The European Council has noted the results of the last tripartite Conference and calls upon the Governments of the Member States to take them into consideration in their economic and social policy decision-making.

The European Council holds the view that the dialogue between the social partners, the Governments of the Member States and the Commission of the European Communities promotes mutual understanding for economic and social policy exigencies and is therefore important for overcoming the problems of growth, stability and employment. The European Council therefore expresses the hope that the contacts between the social partners at European level will be continued.

The President of the European Council has informed the Council that the European Trade Union Confederation is elaborating proposals with a view to improving the methods of work of the tripartite Conference. The Council (Ministers of Economic Affairs and Finance and Ministers of Labour and Social Affairs) is requested to examine these proposals so that further action can be agreed with the social partners.

### Terms of reference for the 'Committee of Wise Men'

In accordance with the proposal made by the President of the French Republic, the European Council agreed at its meeting in Brussels on 4 and 5 December to call upon a number of eminent persons with special knowledge of European affairs to give thought to such affairs.

The members of the Committee will be: Mr Barend Biesheuvel, Mr Edmund Dell and Mr Robert Marjolin.

The European Council invited the Committee to consider the adjustments to the machinery and procedures of the institutions which are required for the proper operation of the Communities on the basis of and in compliance with the Treaties, including their institutional arrangements, and for progress towards European Union. It emphasized the interest it attaches to having available specific proposals in this connection which may be implemented swiftly and which take into account experience to date and the prospective enlargement to Twelve.

The European Council requested the Committee to report back on its conclusions when the Council meets in October 1979.

## Report on European Union

At the same meeting the European Council noted the reports by the Foreign Ministers and by the Commission on progress achieved in the past year towards European Union. The European Council confirmed the importance of the first direct elections to the European Parliament scheduled for 7 to 10 June 1979 and reaffirmed its determination to proceed further along the road to an ever closer union among the peoples of Europe. This, too, was the purpose of its decisions with regard to the European Monetary System and the setting up of a Committee of Wise Men.

The European Council reaffirmed the usefulness of reports on European Union and decided that, as in 1977, they would be published in an appropriate form.

# 1. European Monetary System

## The European Council in Brussels — Outcome and follow-up

*1.1.1* By the end of the year of European Council in Brussels had settled the details of a European Monetary System intended to create a zone of monetary stability in Europe. But this decision, which developed from Commission initiatives of recent years and from the European Council meeting in Bremen last July, immediately ran into difficulties.

The entry into force of the EMS, at first with only six countries, later eight (Italy and Ireland having finally agreed to join), foundered at the end of December over the adoption of the implementing regulations, following a reservation entered by France pending agreement on how monetary compensatory amounts were to be treated within the common agricultural policy. The European Monetary System (EMS) did not therefore start operating on 1 January 1979 as planned.

### From the European Council in Bremen to the setbacks in December

*1.1.2.* Following informal preliminary talks on 6 and 7 July last the Bremen European Council discussed a scheme put forward by several delegations aimed at—to quote the Presidency's statement—'the creation of closer monetary cooperation (European Monetary System) leading to a zone of monetary stability in Europe'.<sup>1</sup>

*1.1.3.* Five months later, the European Council in Brussels on 4 and 5 December took a further step in this direction by formally adopting a Resolution 'on the establishment of the European Monetary System

(EMS) and related matters'.<sup>2</sup> Three Members States however adopted a 'wait and see' attitude—'time for reflection' in the case of Ireland and Italy, and a more definite reservation in the case of the United Kingdom—before committing themselves to full participation in the system.

The next day the Commission confirmed that the EMS had been set up as a Community instrument, and that it would be fully involved in operating the new scheme. The Commission expressed a keen desire to see Ireland and Italy becoming members, and also hoped that the United Kingdom would join as soon as possible. Close contact was maintained with all three countries and a series of implementing measures were drafted in preparation for the Council meeting on Economic and Financial Affairs scheduled for 18 December in Brussels.

*1.1.4.* The auspices were favourable for the Council's discussions, since both Italy (on 12 December) and Ireland (on 15 December) had by then decided to join the EMS. These decisions were formally announced at the Council meeting. The United Kingdom Delegation stated that it was ready to play its part in all aspects of the EMS and that it would follow Community policies on exchange rates in a spirit of sympathetic cooperation, so as to be able to modify its position should the fears of the British Government prove unfounded.

The Council proceeded to discuss a number of matters relating to the introduction and operation of the European Monetary System. It reached a decision in principle on two Regulations: the first would introduce the ECU in the operations of the European Monetary Cooperation Fund (EMCF) with effect from 1 January; the second would permit the

<sup>1</sup> Bull. EC 6-1978, point 1.5.2.

<sup>2</sup> Point 1.1.11.

EMCF to receive monetary reserves from the Member States and to issue ECUs in exchange for these reserves.

However the Council was unable to adopt these Regulations formally at the end of the meeting, since the French Delegation had entered a provisional reservation pending the outcome of the Agriculture Ministers' discussions on the impact of the EMS on the common agricultural policy (the problem of monetary compensatory amounts).

1.1.5. The final setback occurred on 29 December when an official communiqué was released in Paris stating that the French Government considered that the necessary conditions for introducing the EMS had not been met in full and would therefore maintain its reservation, until the Council had found a solution for both problems—the EMS and the monetary compensatory amounts.

For this reason it was not possible to launch the EMS on 1 January 1979 as originally planned.

### The creation of the European Monetary System

#### *The idea of a European monetary system*

1.1.6. The idea of a European monetary system is not new. An initial attempt to organize European monetary relations was made as early as 1970 following the Summit in The Hague in December 1969, at which a decision had been taken in favour of the establishment by stages of economic and monetary union. With this aim in mind, various measures were agreed in 1971 and 1972. In the monetary field, a system of joint floating was set up that subsequently underwent a number of changes in form and membership. In the end, this system (the 'snake') em-

braced only a reduced number of countries (Federal Republic of Germany, Netherlands, Belgium, Luxembourg, Denmark).

The EMS is being created for reasons of both international monetary policy and Community economic policy. Prominent among these is the need to tackle exchange rate instability, with its unmistakable adverse impact on both the fight against inflation and growth. A greater measure of exchange rate stability, notably within the EEC, would be an important factor in any policy to overcome the present crisis since it would have a favourable effect on the production and investment decisions of firms whose views were increasingly influenced by the unforeseeable nature of exchange rate relationships.

#### *The EMS: mechanisms and operation*

1.1.7. The EMS was designed to be established with eight Member States as full members, viz. the countries belonging to the 'snake' plus France, Italy and Ireland, the United Kingdom having decided to delay joining the system.

The EMS is based on a new European monetary unit, the ECU, the composition of which—to be reviewed periodically—will be identical at the outset with that of the European unit of account (EUA), namely: DM 0.828 + UKL 0.0885 + FF 1.15 + LIT 109.0 + HFL 0.286 + BFR 3.66 + LFR 0.140 + DKR 0.217 + IRL 0.00759.

This new instrument, the pillar of the system, will be used as: a denominator (*numéraire*) in the exchange rate mechanism; a basis for establishing a divergence indicator; a denominator for transactions under the intervention and credit mechanisms; a means of settlement between monetary authorities in the European Community.

As part of the EMS, it is planned to set up various mechanisms governing intervention, credit and settlement operations.

*Intervention mechanism* — Like the snake, the new system is to feature an intervention mechanism which is based on a parity grid (adjustable by joint agreement)

