The difficulties of the monetary snake and the EMCF

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The difficulties of the monetary snake and the EMCF [1]

The ‘monetary snake’, the first manifestation of European solidarity on currency matters and of a resolve to be independent of the dollar, was to fall foul of instability.

In mid-1972, the German mark, the Dutch guilder, the Belgian franc and the pound sterling fell prey to speculation that pushed them towards their ceilings. [2] On 23 June, the British Government decided to cease application of the agreement on the narrowing of margins and allowed its currency to float on the exchange markets. This meant that the pound could no longer stay in the tunnel. In January 1973, Italy, which was in a similar situation to that of the United Kingdom, also left the tunnel and the snake. Italy obtained a derogation from the intervention arrangements provided for in the Basel Agreement. Firstly, it was to be allowed not to make reimbursements on the basis of the composition of monetary reserves for the credit it had already obtained by way of very short-term support, a procedure which would have required Italy to transfer gold at the official rate. Secondly, the central bank was to be authorised to intervene in dollars in the future, and not in Community currencies.

The economic situation in the United States continued to deteriorate, and, on 13 February 1973, a second devaluation of the dollar, by 10 %, was necessary. That devaluation and the widespread floating of currencies that ensued heralded the irrevocable collapse of the Bretton Woods system in March 1973.

The fall of the dollar led to the closure of exchange markets in the Community. In the light of these difficulties, the Commission reaffirmed its position ‘in favour of an international monetary system based on fixed but adjustable parities, convertibility of national currencies and including an efficient adjustment process’. [3] It consequently proposed a system whereby European currencies floated jointly in relation to the dollar. The Council met three times (on 4 March, 8 March and 11–12 March 1973) to debate monetary matters, and, at the end of the third such meeting on 12 March, it decided to retain the internal fluctuation margins (‘the snake’) but released the central banks from the obligation to intervene in order to ensure compliance with the initial 4.5 % fluctuation bands for Member States’ currencies vis-à-vis the dollar. ‘The currency snake leaves the tunnel.’ Germany, France, Denmark and the Benelux countries decided to allow their currencies to float jointly within the ‘snake’. The Italian lira, the British pound and the Irish pound were too weak to do so and therefore were authorised to float separately instead of entering the ‘snake’ until such time as their domestic circumstances recovered. As a result, an area of relative stability comprising Benelux, France and Germany was established, and this encouraged Norway and Sweden to join the snake on 14 March. [4] Austria was unilaterally a de facto participant in the snake and Switzerland considered the possibility of joining.

When the exchange markets reopened on 19 March 1973, the German mark was revalued by 3 % in relation to the other five currencies. It was revalued again in June by 5.5 %. The dollar continued to fall, causing the German mark to appreciate [5] and creating new monetary tensions in Europe. Two groups of countries emerged: one whose currencies tended to appreciate, such as Germany, and one whose currencies depreciated, such as France. In September, the Government of the Netherlands unilaterally decided to revalue the guilder, demonstrating a lack of European resolve. As a result, there was a move away from a very rigid exchange rate system inherited from Bretton Woods towards the opposite extreme, namely, over-flexibility through widespread floating of currencies among themselves. The Yom Kippur War of October 1973 in the Middle East, the embargo on oil products and the energy crisis that ensued, quickly compounded by a financial crisis, accentuated the differences. France left the 'snake' in January 1974 but rejoined in July 1975, only to withdraw once more the following year, leaving behind a 'mini-snake' generally thought of as a 'German mark area'. The 'snake' had lost its Community nature. [6] 'Sometimes referred to as the German mark area, the "snake agreement" had the merit of introducing an area of stability into a disordered monetary landscape and of initiating the implementation of a policy of mutual support by the central banks.' [7]

The only genuine step forward in 1973, a difficult year, was the establishment of the European Monetary Cooperation Fund (EMCF). Point III(8) of the resolution adopted by the Council of Ministers of the Community on 22 March 1971 [8] provided for the establishment of a European Monetary Cooperation Fund (EMCF). This fund was regarded as a desirable, although not indispensable, stage in the Community organisation of the central banks. At its meeting of 21 March 1972, following this resolution, the Council of Ministers asked the Monetary Committee and the Committee of Governors of the Central Banks to draw up a report by 30 June 1972 on the 'organisation, functions and statutes of a European Monetary Cooperation Fund'. [9] The Council undertook to study this report and to give a ruling on its conclusions before the end of the same year.

Pursuant to that mandate, the two committees established a joint group of experts which drew up a draft report on the principal technical aspects of the issue. At its meetings of 11 July and 5 September 1972, the experts discussed this report and aimed to identify the key options available. [10] The debates were lively, and opinion was divided even on whether it was appropriate to establish the fund, and on the fund's organisation and operation, the use of a European monetary unit of account and the pooling of reserves.

Broadly speaking, three approaches could be identified: the first was very guarded, the second was marginally positive and the third was clearly in favour of establishing the fund. The most reticent countries were France and Germany, but for different reasons. The French authorities were, in principle, mistrustful of new Community institutions because they had a tendency to increase their autonomy and to extend their decision-making powers at the expense of the Council of Ministers and other pre-existing bodies. With regard to the future organisation of the fund, the French experts stated that 'although the technical issues fell within the scope of the issuing institutions, the monetary decisions fell within the purview of the government authorities'. [11]

German reluctance stemmed from fears that Germany's finances would be used by the fund to help to prop up less-developed members whose economic management was lax. Paris and Bonn would have been satisfied with a modest body for dialogue on monetary issues and statistical information. The Netherlands, Italy, the United Kingdom and the three other candidate countries (Denmark, Ireland and Norway) backed a less restrictive approach. They were of the view that the fund should conduct Community interventions using a multilateral technique for which a European unit of account would be used [12] for accounting purposes. Italy went one step further and asked for 'the Ten to transfer a proportionate part of their dollar exchange, composite reserves and national currencies to the EMCF to a sum of 2.4 billion dollars'. [13] In agreement with the Commission proposal that the Monetary Cooperation Fund should be provided with its own resources and act to some extent as an airlock between national reserves and the world outside, Belgium, also representing Luxembourg because of the monetary partnership between the two countries, expressed a much more positive attitude and proposed providing for a multilateralisation mechanism as well. That mechanism would allow the very short-term credits (15 days) which were necessary for the Community interventions to become, quasi-automatically, the short-term support and medium-term intergovernmental assistance already provided for by the EEC. In that respect, the EMCF was the beginnings of a European Central Bank. [14] Belgian officials [15] explained that the attainment of those objectives would have a particular psychological effect and would constitute genuine proof of monetary solidarity within the Community.

Following negotiations which ended on 10 August 1972, the two committees structured their joint conclusions in the form of a report on the organisation and operation of the EMCF. This document also acted as a draft opinion to the Council and the Commission. [16] The opinion was based on two main conclusions. [17] The first was that, in addition to the arguments in principle in favour of the establishment of the fund — the initial contribution to the progressive attainment of economic and monetary union and a specific demonstration of the resolve of the member countries to reinforce their cooperation on monetary matters — there were two other arguments of a more practical nature. The fund could act as an instrument to implement the Community policy to reduce fluctuation margins (by conducting interventions at foreign exchange centres on behalf of the issuing institutions and settling the positions resulting from those interventions). Furthermore, depending on the degree of monetary solidarity sought, the fund could perform increasingly complex roles, [18] including the pooling of a proportion of member countries' reserves. The experts on the Monetary Committee came out in favour of a fund with fairly broad powers, but were of the view that it would be premature to entrust it with the task of managing the national reserves. A 'European unit of account' would also be defined and could be used in accountancy procedures for the fund's operations and as the basis for certain payments.

'The discussions that preceded the drafting of the document reveal the experts' concern about the fund's genuine scope and effectiveness, which will depend on the powers conferred upon it and the degree of discipline that will attend its rules of operation. […] If the fund receives only minor powers, its establishment would present more disadvantages than advantages. It would not provide any specific substance to Europe's monetary personality and would not invest Europe with the means to protect itself effectively from the dangers of speculative capital and national inflation.' [19] However, the fact of conferring significant powers upon the fund, including interventions at foreign exchange centres, the multilateralisation of settlements, the use of a unit of account and the provision of short-term support, would not be enough to provide the Community with genuine autonomy in external financing. 'The important factor […] is the monetary policy that will be followed by those in charge in Europe, both internally and externally.' [20] That was why the process of setting a fund of this nature in train had to be preceded by an agreement on the very principles of European monetary policy. It would firstly be indispensable to set a ceiling for interventions under the fund. Above this ceiling, governments would either have to revalue European foreign currencies or implement capital controls; in any event, there would have to be changes to national and common economic policies. A measure of restraint would also have to be introduced on internal payments to accelerate settlements and prevent persistence of sustained debit positions. [21] A charter of this kind would fall foul of serious difficulties, first because it would have to take account of the individual circumstances of the economies concerned and secondly because it would have a bearing on the troubled matter of relations between the Community and the United States. There was a fear that ‘if the fund was authorised to absorb all dollars presented to it, it would provide precious help to the US Treasury yet without safeguarding European interests’. [22]

Meeting in Rome on 10 and 11 September 1972, the Ministers for Finance and Foreign Affairs of the enlarged Community (the Six plus the four other accession candidates: the United Kingdom, Ireland, Denmark and Norway) agreed on the need to establish a European Monetary Cooperation Fund (EMCF) from the start of the first stage of economic and monetary union. Their decision was based on the experts’ most prudent proposal and made the fund a simple umbrella structure for cooperation between the central banks. [23]

On 19, 20 and 21 October 1972, the Heads of State or Government of the enlarged Community met in Paris at the invitation of President Georges Pompidou. In an initial official joint statement published after the summit, [24] the Nine set out the objectives and policies to be pursued in order to achieve a European union. [25] At the same time, they also formally reaffirmed the objective of economic and monetary union, to be completed no later than 31 December 1980, [26] which would be a guarantee of stability and growth, the foundation of their solidarity and the indispensable basis for social progress, while ending disparities between the regions. While reaffirming the principle that fixed but adjustable parities between the Community currencies constituted ‘an essential basis for the achievement of the union’, the statement refers to the establishment of the EMCF before 1 April 1973, states that it is to be administered by the Committee of Governors of the Central Banks and outlines its principal powers. [27] The need for close coordination of the Member States’ economic policies was reiterated. [28] The Nine also hoped to secure a common attitude to the international monetary system (international regulation of the supply of liquidity, reduction in the role of national currencies (meaning the pound sterling and the US dollar) as reserve instruments, equal rights and duties, and responsibilities towards underdeveloped countries). [29]

The EMCF was established on 3 April 1973 [30] and was the kernel of the future organisation of the central banks at Community level. Its primary aim was to oversee the proper functioning of the progressive narrowing of the fluctuation margins between the Community currencies. It also had to monitor interventions in Community currencies on the exchange markets. Finally, it was responsible for settlements between central banks leading to a concerted policy on reserves. The fund had legal personality and was administered by a board comprising the governors of the national central banks [31] and one representative from the Commission (who was not a member of the board in the strict sense: he had the right of address, but not the right to vote). Generally, it had to abide by the agreements between the central banks on the progressive narrowing of margins and short-term support. [32] However, the fund did not have its own resources, and its powers were limited because the principle of pooling reserves was not adopted. [33] Following a diplomatic offensive strewn with problems, the Luxembourg Government highlighted its capital city’s status as the ‘provisional place of work of the Community financial bodies’ and won its case, especially as it had been putting the logistics in place to ensure the fund’s satisfactory operation: [34] the provisional seat of the EMCF was established in Luxembourg. [35]

The responsibilities of the EMCF related to accountancy procedures for the operation of credit mechanisms and interventions within the framework of the exchange mechanism, as well as the administration of the various short- or medium-term support mechanisms. In reality, the fund was purely an accounting body, [36] and its transactions were conducted by the Bank for International Settlements. No controls on movements of capital, especially transactions in Eurodollars, were introduced.

[1] Unless otherwise indicated, the source of all the documents cited in this study is www.cvce.eu.

[2] Métais, Joël, 'L'attente et l'incertitude', in *Cahiers Français*, No 196, May–June 1980, pp. 7–8

[3] Ibid.

[4] Leboutte, René, *Histoire économique et sociale de la construction européenne*, PIE Peter Lang, 2008, p. 234

[5] The German mark and the US dollar operated in line with the principle of interdependence: when one appreciated, the other depreciated, and vice versa.

[6] See Turot, Paul, *Le serpent monétaire européen*, Éditions de l'Épargne, Paris, 1976

[7] Werner, Pierre, *Itinéraires luxembourgeois et européens. Évolutions et souvenirs: 1945–1985*, 2 volumes, Éditions Saint-Paul, Luxembourg, 1992, Volume 2, p. 140

[8] 'Resolution of the Council and of the Representatives of the Governments of the Member States on the attainment by stages of economic and monetary union in the Community', in Official Journal of the European Communities, C 28, 27.03.1971, pp. 1–4. (Document consulted on 10 October 2012.)

[9] 'Resolution of the Council and of the Representatives of the Governments of the Member States of 21 March 1972 on the application of the Resolution of 22 March 1971 on the attainment by stages of economic and monetary union in the Community', in Official Journal of the European Communities, C 38, 18.04.1972, English special edition: Series II Volume IX pp. 65–66. (Document consulted on 10 October 2012.)

[10] 'Monetary policy in the countries of the European Economic Community', 1972. Monetary Committee of the European Communities. Historical Archives of the Commission of the European Communities, Brussels, 1972

[11] 'Note on the European Monetary Cooperation Fund', 26 July 1972, ref. GMC/GM, No 227/CE. Ministry of Foreign and European Affairs of the French Republic, EC Collection, Directorate for Economic and Financial Affairs, Economic Cooperation Department, PM series, Vol. 973 EMU, file PM 19.9. Diplomatic Archives, La Courneuve

[12] The European unit of account in question was almost certainly the SDR defined in gold as 0.88167 grams of fine gold.

[13] Olivi, Bino; Giacone, Alessandro. *L'Europe difficile. Histoire politique de la construction européenne*, Éditions Gallimard, Paris, 2007, pp. 186–194 and 459. Italy's proposal was interpreted as an attempt to take the quickest possible action to stave off dips in the lira. However, Rinaldo Ossola, Vice-President of the Banca d'Italia, stated that monetary gold should be held separately from the pool.

[14] Sixty-first meeting of the Committee of Governors of the Central Banks of the Member States of the European Economic Community. Basel: Committee of Governors of the Central Banks, Monday 11 July 1972 at 10 a.m. Pierre Werner family archives, ref. PW 041, case entitled 'Questions monétaires 1971–1972, réforme du système monétaire international' [Monetary issues 1971–1972, reform of the International Monetary System].

[15] Especially Jacques Mertens de Wilmars. As the adviser to Baron Hubert Ansiaux (Chairman of the Committee of Governors of the Central Banks) and alternate on the Werner Committee, Jacques Mertens de Wilmars played an active role in drafting the interim Werner Report. He was also the person who confirmed the aforementioned view within the Committee of Governors of the Central Banks.

[16] See the minutes and documents relating to the 62nd meeting of the Committee of Governors of the Central Banks of the Member States of the European Economic Community (confidential). Basel: 11 September 1972, at 10 a.m. Archives of the European Central Bank, Frankfurt.

[17] See 'Mise au point définitive de l'avis du Comité des gouverneurs des banques centrales sur le rapport du groupe d'experts présidé par M. Mertens de Wilmars sur un Fonds européen de coopération monétaire (confidentiel)' [Finalisation of the opinion of the Committee of Governors of the Central Banks on the report by the group of experts chaired by Mertens de Wilmars on a European Monetary Cooperation Fund (confidential)]. August 1972. Committee of Governors of the Central Banks of the Member States of the European Economic Community. Archives of the European Central Bank, Frankfurt

[18] In particular:

- concerted action between the European Central Banks (more particularly in relation to intervention on foreign exchange);
- links with central banks outside the Community;
- multilateralisation of settlements between the member countries (regular auditing of the positions of the Member States following joint interventions at exchange centres);
- opening of short-term credit facilities.

[19] See the minutes and documents relating to the 62nd meeting of the Committee of Governors of the Central Banks of the Member States of the European Economic Community (confidential). Basel: 11 September 1972 at 10 a.m. Archives of the European Central Bank, Frankfurt.

[20] Ibid.

[21] Leaving to one side the option of settlements in gold and by way of SDRs, discipline of this kind would be able to be secured only via restrictions on automatic credits and the general adoption of the conditional credits procedure.

[22] See 'The European Monetary Cooperation Fund', note ref. GMC/RC, Paris: 8 September 1972, Ministry of Foreign and European Affairs of the French Republic, EC Collection, Directorate of Economic and Financial Affairs, Economic

Cooperation Department, PM series, Vol. 975, EMCF file PM 19.9. Diplomatic Archives, La Courneuve
[23] See 'Note for the Chairman. Meeting of the Ministers for Foreign Affairs and the Ministers for Finance of the 10 countries of the enlarged Community in Rome (10–11 September 1972)', Paris: 14 September 1972, ref. 5AG2 7/PR/CT, Ministry of Foreign and European Affairs of the French Republic, EC Collection, Directorate of Economic and Financial Affairs, Economic Cooperation Department, PM series, Vol. 975, EMCF file PM 19.9. Diplomatic Archives, La Courneuve
[24] Statement from the Paris Summit (19 to 21 October 1972). Bulletin of the European Communities. October 1972, No 10. Office for Official Publications of the European Communities, Luxembourg. (Document consulted on 10 October 2012.)
[25] 'When he opened the Paris Summit in October 1972, standing before nine delegations instead of six (Great Britain, Denmark and Ireland had joined the founding countries), Georges Pompidou had a stroke of linguistic inspiration that transcended playground quarrels in its disarming simplicity. He expressed the wish that the decade 1970–1980 should see the establishment of a "European union" that was determined to fulfil its destiny. The decision was adopted, and it was decided once more to entrust one of our colleagues, this time Leo Tindemans, with the responsibility of drafting a report on implementing that project.' See Werner, Pierre, 'Les perplexités institutionnelles de l'Union européenne', in *La problématique de l'Union monétaire européenne*, Institut Grand-Ducal, Political Sciences and Ethics Section, Journals of the Institute (collection), Vol. 12, Luxembourg, 1997, p. 28
[26] 'The Heads of State or of Government reaffirm the determination of the Member States of the enlarged European Communities irreversibly to achieve the Economic and Monetary Union, confirming all the elements of the instruments adopted by the Council and by the representatives of Member States on 22 March, 1971, and 21 March, 1972.

The necessary decisions should be taken in the course of 1973 so as to allow the transition to the second stage of the Economic and Monetary Union on 1 January, 1974, and with a view to its completion not later than 31 December, 1980.

The Heads of State or of Government reaffirmed the principle of parallel progress in the different fields of the Economic and Monetary Union.'

See 'Statement from the Paris Summit (19 to 21 October 1972)'. Section IV. *Economic and Monetary Questions.* Bulletin of the European Communities. October 1972, No 10. Office for Official Publications of the European Communities, Luxembourg
[27] Ibid., point 2: 'They declared that fixed but adjustable parities between their currencies constitute an essential basis for the achievement of the Union and expressed their determination to set up within the Community mechanisms for protection and mutual support which would enable Member States to ensure that they are respected.

They decided to institute before 1 April, 1973, by solemn instrument, based on the EEC Treaty, a European Monetary Co-operation Fund which will be administered by the Committee of Governors of Central Banks within the context of general guidelines on economic policy laid down by the Council of Ministers. In an initial phase the Fund will operate on the following basis:

— concerted action among the Central Banks for the purposes of narrowing the margins of fluctuation between their currencies;
— the multilateralization of positions resulting from interventions in Community currencies and the multilateralization of intra-Community settlements;
— the use for this purpose of a European monetary unit of account;
— the administration of short-term monetary support among the Central Banks;
— the very short-term financing of the agreement on the narrowing of margins and short-term monetary support will be grouped together in the Fund under a renovated mechanism; to this end, short-term support will be adjusted on the technical plane without modifying its essential characteristics and in particular without modifying the consultation procedures they involve.

The competent bodies of the Community shall submit reports:
— not later than 30 September, 1973, on the adjustment of short-term support;
— not later than 31 December, 1973, on the conditions for the progressive pooling of reserves.'

[28] 'The Heads of State or of Government stressed the need to coordinate more closely the economic policies of the Community and for this purpose to introduce more effective Community procedures.

Under existing economic conditions they consider that priority should be given to the fight against inflation and to a return to price stability. They instructed their competent Ministers to adopt, on the occasion of the enlarged Council of 30 and 31 October, 1972, precise measures in the various fields which lend themselves to effective and realistic short-term action towards these objectives and which take account of the respective situations of the countries of the enlarged Community.'

See 'Statement from the Paris Summit (19 to 21 October 1972)'. Section IV. *Economic and Monetary Questions.* Bulletin of the European Communities. October 1972, No 10. Office for Official Publications of the European Communities,

Luxembourg
[29] 'The Heads of State or of Government express their determination that the Member States of the enlarged Community should contribute by a common attitude to directing the reform of the international monetary system towards the introduction of an equitable and durable order.

They consider that this system should be based on the following principles:
— fixed but adjustable parities,
— the general convertibility of currencies,
— effective international regulation of the world supply of liquidities,
— a reduction in the role of national currencies as reserve instruments,
— the effective and equitable functioning of the adjustment process,
— equal rights and duties for all participants in the system,
— the need to lessen the destabilising effects of short-term capital movements,
— the taking into account of the interests of the developing countries.

Such a system would be fully compatible with the achievement of the Economic and Monetary Union.'
[30] The EMCF was established under Regulation (EEC) No 907/73 of the Council of 3 April 1973 establishing a European Monetary Cooperation Fund. Official Journal L 089, 5/4/1973 pp. 2–5. On 1 January 1994, the European Monetary Institute, the germ of the future European Central Bank, took over from the EMCF. (Document consulted on 10 October 2012.)
[31] The unusual situation of Luxembourg is worthy of note. Luxembourg was usually represented by the National Bank of Belgium (BNB), in accordance with the Convention on Economic Union between Belgium and Luxembourg. Luxembourg had one representative who was able to take part in decisions of the Board of Governors whenever the rights and obligations of the Grand Duchy of Luxembourg were not exercised by the BNB. See Article 1, Statutes of the EMCF of 28 June 1973. Reproduced in *Monetary Committee, Compendium of Community Monetary Texts, 1958–1973*, OPOCE, Luxembourg, 1974, p. 85.
[32] See Ehlermann, Claus-Dieter, 'Die Errichtung des Europäischen Fonds für Währungspolitische Zusammenarbeit', in *Europarecht*, Vol. 8, Munich, 1973, H.3, p. 193
[33] See Ansiaux, Hubert (Baron); Dessart, Michel, *Dossier pour l'histoire de l'Europe monétaire 1958–1973*, Michel Dessart (Ed), Brussels, 1975, pp. 117–125
[34] Luxembourg and Paris were the candidates to be the seat of the EMCF. Luxembourg ultimately won the day. See 'Mémorandum du gouvernement luxembourgeois concernant le siège du FECOM' [Memorandum of the Luxembourg Government on the seat of the EMCF], 18 December 1972, Embassy of Luxembourg in France. Pierre Werner family archives. See also 'Adresse diplomatique à Paris: Conseil des 25 et 26 juin 1973: Lieu d'implantation du Fonds européen de coopération monétaire' [Diplomatic address in Paris, Council of 25 and 26 June 1973: Place of establishment of the EMCF.] Telegram from Brussels, No 2133–2141 of 15 June 1973, Ministry of Foreign and European Affairs of the French Republic, EC Collection, Directorate of Economic and Financial Affairs, Economic Cooperation Department, PM, Vol. 975-1, EMCF file PM 19.9. Diplomatic Archives, La Courneuve
[35] 'Decision of the Representatives of the Governments of the Member States of 24 July 1973 on the provisional location of the European Monetary Cooperation Fund (73/208/EEC)'. In Official Journal L 207 of 28/7/1973 p. 46. (Document consulted on 10 October 2012.)
[36] The EMCF meetings were entirely a matter of form; discussions between the governors were held within the Committee of Governors until the establishment of the European Monetary Institute in 1994, which inherited the EMCF's powers.