European Fund for Monetary Cooperation: Objectives and Operating Guidelines[1]

1. Operational Objectives of the European Fund for Monetary Cooperation

The objectives of the European Fund for Monetary Cooperation (henceforth referred to as the European Fund) may be considered from two points of view: as concrete aims to be realised immediately within the framework of the existing structure; or as longer-term ideals to be achieved through a scheme involving institutional innovations. In the former case the main problems to be solved concern cooperation in the field of exchange rates, whereas in the latter they tend rather to concern monetary policy cooperation.

This paper discusses a number of propositions aimed at solving exchange rate problems within the context of the present institutional structure, without, however, overlooking the possibility of proceeding to broader and closer forms of monetary cooperation.

As is known, it was officially proposed to set up a European Monetary Fund in December 1969, at the Hague Conference, when the heads of State or Government decided to move ahead the process of European economic and monetary unification.

To implement that decision, the EEC Council assigned a working party — consisting of the chairmen of the various Community committees (anti-cyclical policy, medium-term economic policy, balance-of-payments policy, Governors' Committee and monetary committee) and presided by the Prime Minister of Luxembourg, Pierre Werner — the task of studying the possibility of accomplishing economic and monetary union among the EEC countries.

---

[1] Apart from some updating, this is the text of a paper discussed at the Wingspread Conference (organized by Chicago University in July, 1972) on domestic monetary policies and the international financial system.

I would like to thank dott. Ercole Tuccimei for his help in bringing the text up to date.

With regard to monetary union, the report prepared by the working party, known as the " Werner Report " proposed to achieve, within a ten year period, the complete liberalization of capital movements, the abolition of exchange-rate fluctuation margins and the setting up of irrevocably fixed parity ratios.

In order to achieve these objectives the Werner Report envisaged that a European Fund for Monetary Cooperation be set up to foster, in a first stage, the coordination of Central Bank interventions on the foreign exchange markets, but destined at a later date to take up the function of managing common reserves within the framework of the future Community central banking system.

These suggestions, accepted by the EEC Council of Ministers in the Resolutions of March 22, 1971 (point II, 8) and of March 21, 1972 (point III, 4), were officially ratified at the Conference of heads of State or Government held in Paris in October 1972. In fact, it was decided on that occasion to set up a European Fund for Monetary Cooperation which would be managed by the Committee of Central Bank Governors within the framework of the general economic policy guidelines drawn up by the Council of Ministers.

With regulation No. 907/73 of April 3, 1973, the EEC Council created the EFMC and at the same time duly approved its statutes.[2]

The Fund's operations are expressed in a European monetary unit of account of a value of 0.88867088 grammes of fine gold. The value of the unit of account changes automatically when all the member states alter the parity or central rate of their currency simultaneously in the same direction. More specifically, Article 5 of the Statutes states that the value of the unit of account is changed automatically:

— where all the parities change in the same proportion: in the same direction and by the same proportion as the changes which have taken place;

— where the parities change in different proportions: in the same direction and proportion as the smallest change in parity, unless the Council decides otherwise.

The EFMC has legal personality. It is directed and managed by a Board of Governors consisting of members of the Committee of Governors and a representative of the EEC Commission. A member of the Luxembourg monetary authorities also sits on the Board of Governors and takes part in decisions whenever the rights and obligations of the Grand Duchy of Luxembourg are not exercised by the National Bank of Belgium on behalf of the two member states of the Belgo-Luxembourg Economic Union.

2 Since the Fund has legal personality and therefore also has rights and obligations in relation to third parties, it was decided when setting up the Fund to use the technical form of a Regulation which, out of all the Community acts, is the only one directly applicable in the member states.

The European Fund, in its rôle as a technical instrument for foreign exchange operations of the individual Community countries, should perform the following functions: (a) it should act as the central institution for recording market exchange rates; (b) it should coordinate intervention within the margins agreed upon by the central banks of the EEC countries for the fluctuation of exchange rates around the central rate; (c) it should record and settle the debtor and creditor positions arising out of the individual Comunity countries' foreign exchange operations.

The first of these functions would reduce the cost and the time required for the transmission of information between the official foreign exchange offices of the individual Community countries. In this connection it is worthwhile to recall the Basle agreement of the Committee of EEC Central-Bank Governors,[3] under which, as of April 24 of this year interventions are carried out in Community currencies to prevent the fluctuation margin between these currencies from exceeding 2.25 per cent, the same margin as is envisaged vis-à-vis the dollar. In fact this arrangement, especially if it were also to provide for intervention within the fluctuation margins, will tend to make the immediate and continuous centralisation of exchange-rate quotations on the various markets even more valuable, since the evaluation of the alternative for arbitrage will have to be extended to all the possible combination of rates between EEC currencies and between those currencies and the dollar. Important though this function may be, however, it would not by itself justify the creation of the European Fund, in that it could be performed merely by a central office serving all the Community countries for the collection and coordination of foreign exchange quotations. An information centre of this kind would, in any event, be extremely useful, especially if its services were to be made available, as I would

3 Agreement on the narrowing of fluctuation margins of the exchange rates of EEC currencies (Basle, April 10, 1972).

propose, to all foreign exchange dealers, as well as to the central banks.

The second function (the coordination of interventions within the margins of exchange fluctuation) implies the supply to the EEC monetary authorities of information enabling them to assess the cyclical and balance-of-payments situation of the individual EEC countries. This function would appear to be even more useful in view of the fact that decisions regarding intervention within the margins must be based on sound and objective evaluation of the balance-of-payments situation of certain countries in order to justify the modification of the pattern of the Community balance of payments that would result from intervention only at the outer limits of the fluctuation margins.

The third function, namely the offsetting and settlement of debtor and creditor positions arising from the foreign exchange operations of the individual Community countries, enables a reduction of the volume of currency transfers and the need for working balances. The offsetting mechanism requires centralizing exchange operations expressed in different currencies and postponing the settlement of the same operations. For this purpose these operations should be made homogeneous, and their settlement should not be carried out immediately but deferred until the end of a certain period. Thus, if country A were a creditor for 100 and a debtor for 150 with country B, there would be bilateral compensation for 100 and transfer would be required for only 50. Furthermore, if country C were a debtor for 50 with A and creditor for the same amount with B, there would be no need whatsoever for an actual transfer, provided that offsetting arrangement was on a multilateral basis and that the payment instruments utilized by all the members of the system were convertible.

2. Foreign Exchange Intervention Technique Agreed Upon at Basle

Before proceeding to discuss the possible solution for the offsetting of the EEC countries' debtor and creditor position, it is worthwhile to briefly recall the contents of the Basle agreement on foreign exchange rate intervention. It should be noted that the dollar is no longer considered as the point of reference, since interventions in dollars and in Community currencies are placed on an equal footing. The

rates of exchange between the EEC currencies and between those currencies and the dollar thus lie within the same band. The limits of the band are determined, at any given time, by the maximum permissible margin of 2.25 per cent between the exchange rates of the most appreciated and the most depreciated currency. This band is then allowed to fluctuate, over time, within margins of 2.25 per cent on either side of the parity or central rate.

The trend and the width of the fluctuation band at any given time between EEC currencies and between those currencies and the dollar, and the range of rates, over time, whose limits are determined by the margin of 2.25 per cent on either side of the central rate vis-à-vis the dollar (or, as current jargon has it, the undulations and dimensions of the snake in the Smithsonian tunnel) depend on: (a) the global Community exchange position in dollars; (b) the exchange position between the EEC currencies; and (c) the type and volume of the exchange interventions undertaken by the EEC monetary authorities.

The first factor determines the position of the exchange rates band between EEC currencies and between those currencies and the dollar in relation to the parity line. The band therefore, tends to move up (+ 2.25 per cent, if the rate is quoted indirect for direct) or down (— 2.25 per cent) following a global Community deficit or surplus in dollars.

The second factor conditions the width of the exchange rate fluctuation band, which will be proportionately greater as the degree of exchange positions disequilibria within the EEC area increases.

As to the third factor, finally, if it operates on the exchange rate band when this is not tangent to the wider margins of fluctuation, it brings about changes in the debtor and creditor positions between the EEC countries without affecting the position of the EEC with the dollar area; if, instead, it operates when the band already lies at the outer limit of the range, it modifies the position of the EEC with the dollar area, but not the positions between the EEC countries. In the first case the width of the band tends to remain unchanged, while in the second it tends to narrow, unless dollars are withdrawn from or absorbed in the official reserves of the deficit or the surplus country.

The position of the fluctuation band of exchange rates between EEC currencies and between those currencies and the dollar is influenced by purchases and sales of those currencies by private foreign exchange dealers, as well as by interventions by the monetary autho-

rities of the individual EEC countries. The position of the band therefore, depends on market and institutional factors. It may be observed in this connection that, apart from intervention by the monetary authorities, institutional factors can affect the position of the fluctuation band in so far as foreign exchange dealers are required to observe certain operating regulations. In the case of Italy, for example, the banks empowered to deal in foreign currency are prevented from holding against lire foreign exchange balances except for negligible amounts. In the case of France and Belgium there is a two-tier market: the official, or controlled, market for the settlement of transactions in goods and services; and the financial, or free, market for capital transfers. Recently, in June 1972, a two-tier market, de facto, came into existence also in Italy through the emergence of a specific market for Italian bank notes as distinct from the one for authorized current and capital transactions with abroad.

The ban preventing Italian banks from holding, against lire, foreign exchanges balances — in conjunction with the authorities' obligation, following the Basle agreement, to abstain from any intervention whatsoever as long as exchange rates fluctuate within the margins — tends to have a detrimental effect on the daily and sesasonal stability of lira exchange rates. In practice, such quotations tend to be located at the upper or lower limit of the permissible fluctuation and thereby to shift and increase the mobility of the band of exchange rates between EEC currencies and between those currencies and the dollar.

Bearing also in mind the constraints imposed on the settlement of debtor and creditor position between EEC countries, the influence exerted by the foreign exchange regulations in Italy on the position of the exchange rate fluctuation band can also affect the composition of the country's official reserves. This composition, in fact, depends not so much on the development of the global balance-of-payments position as on the actual daily and seasonal behavior of foreign transactions.

However, the negative influence on the lira stability of the exchange rate — exercised by the ban preventing Italian banks from holding foreign exchange balances against lire — can be reduced, or even nullified, either as a consequence of the management by private non-bank investors of their foreign currency balances, or as a result of those authorizations which allow banks to acquire debt or credit

position toward abroad, or still as an effect of settling dollar-lira swaps between banking system and the Italian Exchange Office.

In the case of countries with a two-tier market the possibilities for arbitrage based on the official-market exchange rates depend on the type of underlying foreign transactions, since foreign exchange operations of a financial nature cannot be negotiated on the official, or controlled, market, even if the arbitrage operations are linked to transactions performed in countries where no distinction is made between the two markets. The two-tier market can also influence the volume of settlements in dollars and the position of the fluctuation band of the exchange rates at a given moment between EEC currencies and between those currencies and the dollar. In fact both the volume of settlements and the position of the band depend not only on the overall surplus or deficit position of the Community as a whole but also on the amount which flow into the financial or free markets.

The foregoing remarks demonstrate that the adoption of common foreign exchange regulations by the EEC countries could have various consequences for the individual countries if they are grafted onto differing institutional structures. This is a concrete evidence of the need — stressed on an earlier occasion in the form of a general deduction [4] — to proceed to European economic unification by way of institutions having common aims and uniform structures. For this purpose it would be appropriate, first, with respect to Italy, to allow banks to hold foreign currency working balances against lire, and second, with reference to France, Belgium and Italy, to eliminate the two-tier market or, as an alternative, to introduce a homogeneous two-tier market in all EEC countries.

3. Methods for Offsetting and Financing EEC Country Balances

Under the terms of the Basle agreement, mentioned previously, the creditor country has the right to reimbursement either in its own currency or through a combination of payment instruments based on the composition of the debtor country's reserves. The financing operations connected with the bilateral compensation are unlimited as to amount and the interest rate applied is the same for all countries,

---

4 Francesco Masera, *Monetary and Exchange Rate Policy of the EEC Countries*, Suerf Series 6A - 1972, page 3.

being fixed on the basis of the arithmetic mean of the official discount rates of the participating central banks. They must be settled at par on the last working day of the month following that in which the contract was entered into. Interventions to keep exchange rate fluctuations within the established margins are carried out, once the reserves in EEC currencies that can be used for this purpose have been exhausted, as follows: (a) by means of short-term swaps, if the national currency reaches the permissible limit of depreciation (2.276 per cent above the central rate if the exchange rate is quoted indirect for direct); (b) by means of outright forward sales, if the national currency reaches the permissible limit of appreciation (— 2.225 per cent).[5] From the foregoing it is clear that the instruments made available to the EEC countries under the terms of the recent Basle agreement allow bilateral compensation operations to be carried out only to the extent that they are reciprocal transactions.

It should be observed at this point that the more frequent the reversal in the balances and the closer the network of foreign exchange operations, the greater the efficacy of the offsetting mechanism. In this case postponement is only a technical means for carrying out the offsetting operations and not a financing instrument. Settlement of a foreign exchange operation is in fact deferred not in order to combine it with the following one, but for the purpose of cancelling it out with a subsequent operation of opposite sign.

The opportunities for short-term offsetting are limited by the fact that official intervention on the exchange market usually occurs only at the outer limits of the fluctuation margins, and therefore generally tends to be associated with prolonged market situations rather than with fortuitous circumstances.[6] It follows that, if the offsetting mechanism is to be effective, the emphasis must be on the centralisation of balances regardless of the currency in which they are expressed and without differentiating between debtor and creditor countries. In other words, it is necessary to aim at a multilateral offsetting mechanism based mainly on a centralization of all settle-

5 The depreciation limit is calculated as 102.276 per cent of the central rate and the appreciation limit as 97.775 per cent. These limits determine, with respect to two EEC currencies, the maximum and minimum quotations consistent with those of the dollar which have a range of ± 1.125 per cent of the central rate of the two EEC currencies.

6 Following the revisions of the Basle agreements, interventions can take place, as of January 1973, also within the fluctuation limits, both in Community currencies and in dollars.

ment operations denominated in various currencies. Obviously, the efficacy of the offsetting instrument could be increased immediately if the EEC countries were to agree to carry out interventions within the fluctuation margins, because in this case, there would be greater frequency of interventions arising out of random events, which by their nature tend to work in opposing directions.

Similarly, centralized use of the offsetting instrument at the European Fund could be brought to bear not only on the foreign exchange debtor and creditor positions of monetary authorities but also on those resulting from the international transfers of other operators. For this purpose a computerised offsetting system could be set up for all Community foreign exchange positions, managed at two different levels: at the national level, by the central bank, for commercial banks' positions; and at the Community level, by the European Fund, for central banks' positions. Threby, the present multiple-star system of the Community would be replaced by a single-star system.

4. Ways and Means of Multilateralising EEC Countries' Foreign Exchange Positions

The operational efficiency of offsetting through the European Fund depends largely on the ways and means adopted for multilateralising payments and settling the resultant balances. Two separate solutions can be considered for this purpose; the one limiting multilateralisation of payments to debtor and creditor positions expressed in Community currencies the other extending it to cover all debtor and creditor positions whether expressed in Community currencies or in dollars.

Both solutions lead to a novation of debt and credit positions through the intermediation of the European Fund and, ultimately, to the conversion of bilateral positions between Community countries into net global positions. This will be done by means of a unit of account,[7] that is, a reference currency which makes fungible claims

7 We should like to propose the name "Eurolibra" for this unit of account, so as to recall ideally the "libra" introduced by Charlemagne, which was the first example of a European unit of account.

and liabilities arising out of intervention in the various Community currencies. It is therefore necessary: (a) to fix a gold parity for the EEC currencies; (b) to calculate on the conversion factor necessary for expressing debtor and creditor positions in the various currencies in terms of units of account on the basis of their respective gold parities; (c) to adjust this conversion factor to take into account the depreciation or appreciation (obtained on the foreign exchange market at the time of conversion into units of account) of the debtor country's currency vis-à-vis the currency in which the debt is expressed.

Should the first solution be adopted, the European Fund will have a balanced debit and credit position in terms of units of account, and will operate merely as an intermediary by paying out to net creditors reserve assets of the type and amount received from the debtors. In this case the Fund has no need to hold operating funds of its own, but its operational scope for compensation of debtor and creditor positions is limited, especially if no provision is made to allow for automatic credit facilities between Community countries by lengthening the periods for settlement.[8]

Greater scope for compensation is offered by the second solution, namely multilateralization of debtor and creditor positions expressed either in EEC currencies or in dollars. In this case, however, there is no equilibrium of debtor and creditor positions in the European Fund and the need arises to provide the Fund itself with dollar resources for the settlement of positions expressed in that currency.

If this solution were accepted it could be decided that each country would subscribe a participation quota to the Fund — equal in amount to, say, the quota fixed for short-term monetary support, or a multiple thereof — which would be payable in dollars in an amount equivalent to the quota. The sums thus paid into the Fund would be utilisable for making the necessary settlements in respect of interventions by central banks on the foreign exchange market. In carrying out this function the European Fund could also grant advances, from its own dollar resources, to participants (over and above the amount of the quotas paid in) until the date for settlement of the balances remaining after the multilateral compensation transactions have been effected. On that date, for instance at the end of the month the dollar quotas paid into the Fund by the individual EEC countries would have to be restored in a manner which would depend on the scheme adopted for compensation. In this regard two procedures are possible: one resulting in compensation of debtor and creditor positions in dollars separately from that of positions in EEC currencies; the other bringing about a general compensation of balances, irrespective of the currency, and hence the centralisation of all balances. This latter procedure gives the maximum scope for compensation transactions and conforms more closely to a Community operational scheme which places intervention commitments in dollars and in EEC currencies on the same footing. Another point in favour of the second procedure is that the composition of debit and credit balances in the various currencies and the very size of these balances will depend not only on the way in which the relationships of individual EEC countries vis-à-vis the various currency areas develop, but also on the arbitrages and the interventions, in foreign exchange effected in the various currencies, as well as on the width of the fluctuation margins that are agreed upon. With regard to this matter it should be pointed out that any settlement of balances expressed in EEC currencies on the basis of the composition of the debtor countries's reserves, as agreed in Basle, might lead to outpayments made partly in gold or instruments similar to gold. The latter payments arise in connection with the taking-up of debtor positions as a result of deficits stemming not from direct transactions but from indirect arbitrage operations performed because of the gains operators in the creditor country may realize by converting their dollar receipts into the currency of the debtor country.[9] That being said, if it is decided to compensate dollar positions separately from EEC currency positions, it will be

[8] This solution corresponds to that envisaged in the Statutes of the European Fund issued in April 1973, according to which, during the first stage of activity, only the multilateral character of balances stemming from interventions by central banks in Community currencies as well as of intra-Community settlements is ensured.

[9] From January 1st, 1973, with regard to the gold portion of settlements of debit positions resulting form interventions in Community currencies, the parties concerned may resort to gold sales with repurchase options or to swaps of gold against the creditor's currency which are settled directly between the parties or with the intermediation of international bodies, or to the postponement of repayment of the credit originally granted; all operations are renewable every three months until March 31, 1975. Moreover, the-e operations can be settled in advance through the repurchase of the creditor's currency on the market if said creditor is in agreement, through the conveyance of gold or gold-convertible instruments, or through the conveyance of dollars and other currencies acceptable to the creditor. These optional solutions (in the event of disagreement between the parties, the debtor's choice prevails) are applicable until the European Fund for Monetary Cooperation comes into being.

necessary: (a) to restore the quotas paid in dollars by the individual EEC countries, which would also have to repay advances and balance net positions in dollars; (b) to settle unit-of-account positions arising from debts and credits originally expressed in EEC currencies by payment of the countervalue, unless it is proposed to have recourse to the financing envisaged in the form of short term swap operations or to outright forward sales. In this case settlement takes place, as already stated, at the end of the month following that in which the financing was granted.

If the scheme for a general offsetting of balances, regardless of the currency involved, were adopted, the end-of-month settlement of position in units of account would be accomplished by means of balancing payments in dollars so as to restore the quotas paid in that currency by the EEC countries. Any excess of dollars over and above the sum of the quotas paid would, however, be divided out among the net creditor countries in proportion to their credits, while any shortfall would be covered by the net debtor countries in proportion to their indebtedness The balance left after this evening-out would give rise to acquisitions of foreign exchange reserves by the EEC creditor countries corresponding to the EEC debtor countries' payments. In this case, too, arrangements should be made to allow recourse to swaps and outright forward sales at the time of settlement in respect of the amounts to be paid to EEC creditor countries.

5. The European Fund as an Instrument for Short-Term Monetary Support and for Harmonizing EEC Countries' Foreign Exchange Reserves

Centralizing at the European Fund the Community countries' external debtor and creditor positions and supplying the Fund with operating balances could be a useful means of implementing the short-term monetary support scheme. In this case, too, the European Fund would operate as a technical tool of the Community monetary authorities both for deciding on support operations and for carrying them out. For the latter purpose, however, it would be necessary to provide the Fund with greater financial resources and to ensure that the composition of these resources largely corresponded to the mean composition of the reserves held by the EEC countries, so as

to enable settlements between EEC countries of debtor and creditor positions arising from reciprocal monetary support operations to be effected in a uniform manner.[10]

It seems appropriate at this stage to examine the question of harmonizing the composition of the reserves held by EEC countries. In this connection, it should be pointed out that provision is made in the Basle agreements for intervention by the EEC monetary authorities not only with a view to narrowing the margins of fluctuation between EEC currencies, but also with a view to establishing a procedure for settling reciprocal debtor and creditor positions that is likely to bring about a harmonization of the official foreign exchange reserves held by the individual EEC countries. For this purpose it has been established that net debtor position vis-à-vis EEC countries should be settled by utilizing firstly the currency of the creditor country and secondly reserve assets held by the debtor country — in proportion to the composition of those reserves. Although the terms of the agreement give the EEC debtor country the assurance of bilateral financing without limitation as to amount for a period not exceeding 60 days, they also call for qualified repayment, with the result that the cost of financing, which, as has been explained, is equal to the arithmetic mean of the partecipating central banks' official discount rates, and is adjusted to take account of the differentiated appreciation between the dollar, on the one hand, and gold and gold-linked assets, on the other.

This adjustment factor could become of such a consequence as to inhibit recourse to Community financing and to induce the authorities to try to solve balance-of-payments difficulties by an immediate change of their parity or central rate.

If the envisaged procedure for the repayment of financing between EEC countries may lead to this consequence while, on the other hand, exchange rate stability and the granting of credits at rates that are not too onerous are considered essential prerequisites for the attainment of Community objectives, then it is clear that the harmonization of reserves should be carried out by means other than those outlined above. Moreover, it may also be illusory

---

[10] The short-term monetary support system set up among the EEC member countries' central banks in February 1969, envisages a system of credit facilities which at present amount to 1,362.5 million units of account. Italy's percentage, which determines the extent of her commitment and credit potential, amounts to 200 million units of account.

to try to achieve this objective of harmonization by arranging for the repayment of credits to be performed in accordance with the composition of the debtor country's reserves, in so far as there are autonomous and variable inflows and outflows of dollars to and from the individual EEC countries, flows of such magnitude as continuously to alter the pattern of these countries' reserve holdings. The objective of harmonizing reserves cannot be pursued as a by-product of the reimbursement of financing; it should be achieved by means of an ad hoc instrument which allows both an even distribution of burdens between the EEC countries and global action on the aggregate total of EEC countries' reserves. An objective of this kind could perhaps be better attained if provisions were made for payments of reserves into the European Fund, the composition of such payments being the same for all EEC countries and commensurate with the quotas established for short-term monetary support.

The centralization of EEC countries' reserves at the European Fund should be performed in such a way as to be related to the Fund's operating requirements and to the amount and duration of the extended reciprocal credits. It goes without saying that the latter will not entail exchange risks. For this purpose it is both necessary and sufficient (i) that the reciprocal credits should be expressed in units of account and (ii) — given the present situation, with currencies not being convertible into gold — that reserves should be centralized at the European Fund in the form of dollars, Community currencies and, possibly, IMF credits. This method of creating a Community reserve fund is appropriate for a scheme providing only technical facilities for the settlement and compensation of EEC countries' reciprocal debt and credit positions and the granting of inter-EEC credits. At this stage of development, which does not involve any EEC monetary union yet, joint management of reserves should be ruled out, each country retaining title to its own quota of the reserves paid to the European Fund. In all cases, both at this stage and at the final stage of monetary integration, payments of reserves to the European Fund should be equal to the quotas fixed for the reciprocal monetary support scheme — or to their multiples — and not to the volume of reserves held by the individual EEC countries. Furthermore, the terms of such payments should be the same for all participants, and hence should not depend on the composition of the individual countries' reserve holdings.

6. The European Fund as a Matrix of the European Federal Bank

The objectives that have just been described — namely the settlement of balances, the centralization of part of the reserves, and the creation of resources in EEC currencies through the operational functions of the European Fund — would help (a) to bring about increased utilization of EEC currencies rather than of the dollar in settling debtor and creditor positions; (b) to set in motion a process of joint management of the reserves required for the Community's external transactions; and (c) to encourage recourse to the European monetary unit for expressing in homogeneous terms, and this with an implicit exchange guarantee, the debtor and creditor positions between EEC countries arising from the utilisation of credit facilities in national currency.

The functions that have been assigned here to the European Fund, which would gradually increase in scope and impact, can still be described as predominantly technical in character, in that they do not encroach to any great extent on the operational autonomy of the individual EEC countries with regard to foreign exchange policies.

However, because the functions performed by the European Fund will only be developed gradually, it is necessary from the outset for a certain operational threshold to be crossed to justify creating the Fund. The decision in this matter should be based on operating costs, comparing those of the present national system with those resulting from the creation of the European Fund.

In this connection it seems that, if the European Fund is to operate efficiently, the following objectives should be pursued from the outset: the multilateral compensation of debtor and creditor positions; the creation of a unit of account as reference currency; and the centralization of foreign and domestic currency reserves at the European Fund for the settlement of final positions and the granting, if need be, of monetary support.

The foregoing remarks, which are concerned essentially with cooperation in the field of foreign exchange should not lead one to overlook the possibility of the European Fund subsequently becoming a suitable model for a new supranational structure for the EEC countries for matters relating the centralization of official reserves and a common currency. In other words, the European Fund could

also be conceived as the formative matrix of the future executive organisation of the Committee for the European Central-Bank Governors.

A qualitative advance could result from the directive which is proposed to issue, assigning to the European Fund the task of taking over the management of the EEC countries' foreign exchange reserves and progressively narrowing the margins of exchange rate fluctuation permitted between EEC currencies up to the point where the margins disappear. Since a directive on these lines tends to affect the degree of autonomy left to national authorities in monetary policy management and in establishing the level of interest rates, it should be based on a two-fold premise: (a) that national inflationary propensities are neutralized, on the one hand by mobility of the factors of production and on the other by fiscal policies aimed at meeting certain social preferences of the Community regarding the goods and services to be produced and consumed, as well as workers' preferences with regard to type and place of work; (b) that importance is attached to the size and nature of balance-of-payments disequilibria purely from the Community viewpoint and no longer from the national angle.

The process of the integration of EEC countries can then lead to the creation of a system of invariable exchange rates within the Community and possibly a system of floating rates against the dollar and against non-EEC currencies in general.

Extension of the European Fund's functions to management of the EEC countries' official reserves, the harmonization of the composition of these reserves and, above all, the elimination of the margins of exchange rate fluctuations around parity or the central rate are stages which, in conjunction with a process of institutional unification in all spheres of economic and political life, should lead to achievement of the final objective of a monetary integration. We have thus reached the threshold of that ideal, longer-term objective which goes beyond the scope of this paper.

Nonetheless, we must not fail to stress the necessity for the European Fund to initiate studies in the near future on the problems concerning the future organization and functions of the European Central Bank, the Fund's ultimate form.[11] The necessary ground-

[11] The following considerations are the result of an exchange of opinions with dott. Tommaso Padoa Schioppa.

work for the correct operation of the future institution must be carried out and particular attention paid to problems concerning the framing of European monetary policy and the harmonization of domestic fiscal and financial systems. Although the relatively small structure of the European Fund will make necessary at first the systematic contribution of external national collaboration, the main feature of the Fund's study programme should be the analysis of problems from a European rather than national viewpoint. Studies on the Central Bank should be focused on the most obvious problems of the moment and aimed at the formulation of workable proposals. Thus, doctrine should be reconciled with European organizational and institutional problems pertinent to Europe.

Within the framework of the European Central Bank's monetary policy, study should be given to the division of tasks and functions of the central and peripheral organs (presumably the former national central banks), taking as the first working hypothesis the feasibility of assigning external problems to the central organ and those concerning internal areas to the peripheral organs.

Regarding the problems involved in harmonizing the fiscal and financial systems, it is necessary to proceed along lines aimed at singling out second best solutions.

In the first place, an approach could take the form of establishing the minimum harmonization, and hence the "federal minimum", necessary for a European Central Bank to function. In the second place, a study could be made of the optimum revision to be introduced into the present fiscal and financial structure. Finally, a study could be made of the form that the European commercial bank should take.

In solving the foregoing problems, particular profit could be gained by carefully going over the most extensive experience of political federation to date, the American one. Inspiration could also be drawn from the national states' internal structures and phenomena such as, for example, the system of subsidized credit in Italy with regard to problems connected with maintaining different interest rates according to regional development requirements, or the financial system organized on partly national and partly regional basis, as in Germany.

Alongside the problems mentioned, attention should be given to others of a more contingent and organizational nature, specifically

those concerning: the gathering of statistical data, the criteria to be followed in choosing the Central Bank's location, and its relations with other international monetary institutions.

Rome, April 1973 FRANCESCO MASERA

REFERENCES

GUIDO CARLI, *Monetary Aspects of British Entry into the Common Market*, Action Committee for the United States of Europe, Fifteenth Session, July 15 and 16, 1969, Brussels.

W.M. CORDEN, "Monetary Integration", *Essays in International Finance*, No. 93, April 1972.

J.M. FLEMING, "On Exchange Rate Unification", *Economic Journal*, September 1971.

H.G. JOHNSON, "Problems of European Monetary Union", *Euromoney*, April 1971.

F.A. LUTZ, *Foreign Exchange Rate Policy and European Economic Integration*, American Enterprise Institute for Public Research, Washington DC., September 1971.

G. MAGNIFICO, "European Monetary Unification for Balanced Growth: A New Approach". *Essays in International Finance*, No. 88, August 1971.

F. MASERA, *Monetary and Exchange Rate Policy of the EEC Countries*, SUERF Series 6A.

F. MASERA, "Problemi monetari e di cambio nel quadro dell'integrazione europea". *Moneta e Credito*, September 1970.

R.A. MUNDELL, *Monetary Theory*, Goodyear Publishing Company Inc. Pacific Palisades, California.

R. OSSOLA, "La Communauté Economique Européenne à un tournant", *Studies in honour of Thorkil Kristensen*, OECD.

R. TRIFFIN, *Rapport sur la création d'un Fonds Européen de Reserves*, Action Committee for the United States of Europe, Sixteenth Session, December 15 and 16 1969, Bonn.

R. TRIFFIN, "Que faire face à la dérive vers les années 1930?", *Bulletin de la Banque Nationale de Belgique*, November 1971.