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### FIRST STAGES TOWARDS THE CREATION OF A EUROPEAN RESERVE BANK

Obviously, the economic and monetary construction of Europe will not be achieved in a single stage, although much has been secured already. This construction calls for a pragmatic approach, centered around the gradual fulfilment of the final objective ultimately chosen.

The purpose of this note is to sketch out some ideas on the nature and pace of possible initial steps that could lead ultimately to Economic and Monetary Union.

To come through the different phases, monetary authorities will need a clear vision :

- not only of the medium-term direction towards which they should be channelling their initiatives in the monetary sphere ;

- but also of the daily implementation of the policies they are responsible for framing and coordinating.

With a view to giving more practical and more visible form to their co-operation on exchange rate and interest rate management, the gradual construction of a permanent body to act and reflect together would be a highly significant step forward. There would be two advantages to this :

- it would demonstrate politically and to the markets, the determination of the governments to progress more actively towards European Union ;

- it would rapidly create effective means, on the eve of the opening of the single European market and in a spirit of co-operation with the other currency zones, to ensure with more efficiency the smooth functioning of the markets.

Two guidelines might inspire the idea of proceeding straight away to lay the foundation stone of a body, that could become the European Reserve Bank (E.R.B.).

First, this body would be built up progressively. Its powers would depend on progress towards the construction of Europe and on the responsibilities that the Member States would be prepared to devolve upon it.

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Second, two benefits would derive from such operational tasks as might be entrusted to it, namely :

- to bring the central bank officials concerned to work together, practically, to harmonize concepts and develop a common approach to decisions ;

- to achieve closer coordination of the management of the various factors affecting monetary trends : exchange rates, interest rates, domestic credit.

The creation of a European Reserve Fund (E.R.F.) -first stage towards the European Reserve Bank (E.R.B.)- right now would produce a hard core around which more ambitious functions could gradually aggregate, the final stage being the realization of an Economic and Monetary Union. This Fund could be built up according to the following plan :

- I - Progressively greater powers in the foreign exchange markets and in the monetary sphere ;
- II - An organization foreshadowing the workings of a European Central Bank
- III - The fulfilment of certain legal and institutional conditions.

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## I - The powers of the E.R.F.

In an international monetary system in which main reserve currencies are floating, markets are worldwide and capital moves freely, close co-operation is required among central banks responsible for keeping their currency within fluctuation margins. Central Banks would significantly enhance the impact of their foreign exchange interventions if, under certain circumstances, they were to decide not only to consult among themselves, but also to act through the agency of a common body. Operations conducted through the E.R.F. would have the advantage of reinforcing the effect of central bank action while permanently focusing attention on visible progress towards the construction of a European monetary union.

The E.R.F.'s task could include :

- 1 - intervening in the foreign exchange market,
- 2 - ultimately taking over the powers of the EMCF,
- 3 - progressively setting up a body to exercise surveillance over monetary and interest rate trends,
- 4 - preparing the institution of a European Central Bank to be put into place by successive stages.

### 1 - Intervention in the foreign exchange market

#### a) Areas of intervention

In the first place, this would concern interventions in third currencies and would be decided on by means of concertation with the central banks concerned. The role of the E.R.F. would be to intervene directly in the markets, thus embodying the cohesion of the monetary authorities in pursuing a common policy towards third currencies. It is here that the role of the E.R.F. would be most directly perceptible and would illustrate the tripolar structure of the international monetary system : the United States, Japan and Europe. This role would of course be exercised in line with the broad thrust of G7 orientations.

Second, the E.R.F. would find itself intervening in Community currencies -in close concertation with the central banks concerned- either intramarginally or at the limits, in order to supplement individual action by central banks when strains appear in the system and require visible affirmation of solidarity.

Clearly, initially at least, the E.R.F.'s role with regard to intervention would be a complementary one, while there would continue to be concerted intervention by the different central banks. But the E.R.F. would have the advantage of ensuring close coordination between the individual actions of the central banks and the overall policy of participants in the Fund.

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## b) Means of intervention

In order to play the role assigned to it in the foreign exchange markets, the E.R.F. would require sufficient currency reserves to enable it to assert vis a vis the markets its capacity for intervening. These reserves would consist of :

- an initial endowment, which would be independent of current contributions in gold and dollars to the EMCF and would represent, for example, initially 10 % of the gold holdings and 10 % of the foreign currency holdings of each of the central banks participating in the European Exchange Rate Mechanism. The currency stock would be paid in dollars ; there would be an additional contribution by participants in their national currency, based on a formula to be defined. This endowment would be made definitively (and not in the form of renewable swaps as is the case with the EMCF) ;

- additional resources in the form of swap lines with the Federal Reserve Bank and, possibly, with the Bank of Japan.

The E.R.F. would manage these reserves itself, thereby further reinforcing -including in the view of the markets- the degree of co-operation between central banks.

## 2 - Subsequent taking over of the powers of the EMCF

In working towards greater exchange rate policy coordination among the members of the E.M.S., and for reasons of simplicity, the body responsible for carrying out interventions probably ought not to remain permanently separate from the one responsible within the Community for managing the holdings of public Ecus and the Community credit mechanisms.

Consequently, it would be appropriate to give immediate acknowledgement to the intention that the E.R.F. should ultimately assume the powers of the EMCF once all the E.E.C.'s central banks have joined the European Reserve Fund.

## 3 - Monetary surveillance

Alongside the creation of a foreign exchange department, the E.R.F. could also set up a monetary policy department responsible for :

- analysing in particular interest rate trends, monetary aggregates and domestic demand,

- thereby underpinning from both a conceptual and a community point of view the concerted management of exchange rates and the coordination of monetary policies among the different participating central banks.

This phase could go hand in hand with the creation of a monetary policy coordinating committee, which would define common surveillance instruments, propose harmonized objectives, and would progressively graduate from an ex post analysis to an ex ante approach to monetary policy adjustment.

In a second phase, one could envisage vesting in the E.R.F. powers to act in support of central banks' actions in their respective money markets, by engaging itself in swap operations for limited amounts, with commercial banks. Such supporting action would in any case be marginal, but pending more structured action (cf. para. 4 below) it could be a first step towards operational functions in the monetary field.

#### 4 - Harmonization of national money markets

A third phase would occur once harmonization of the fundamentals of monetary and exchange rate policies would be practically completed and coordination of domestic demand adjustment (in fiscal terms notably) would be an accomplished fact. It would then be possible to work profitably towards harmonizing the instruments and policies of intervention in national money markets.

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All along these different stages, the ERF would be assigned to prepare the coming of a common currency. In this regard, effective progress in the development of the ecu -without prejudging its future definition and issuing process- should be secured alongside the process leading to the ultimate phase of the monetary union.

## II - Organizational arrangements

The structure of the European Reserve Fund should clearly reflect the conditions prevailing at the time of its creation, in other words it should be sufficiently :

- flexible, so as to adapt to changes in its powers and to the gradual adhesion of all the members of the E.E.C. to its operational function ;

- ambitious, so as to foreshadow the broad outlines of a future European Central Bank.

Also, its officials should be assured of the continuity they need in order to operate effectively.

The organization of the E.R.F. would be based on a collegiate and consensus principle, guaranteeing both :

- that its operations are coherent with those that central banks will continue to perform individually, which implies notably active participation in all the concertations ;

- sufficient delegation of power for it to be able to intervene on its own initiative, within certain limits.

The few above principles are not intended to define the E.R.F.'s operating procedures in full, which should be dealt with by appropriate discussion.

### A/ Eligibility

All the E.E.C.'s central banks would be eligible to join the E.R.F. However, membership would be subject tot :

- participation in the exchange rate mechanism,
- the pooling of a portion of their reserves.

### B/ Management

Foreshadowing the future organization of a European Central Bank the management of the E.R.F. would consist of :

1. **A board of Directors** : this would comprise automatically the Governors of each central bank participating in the E.R.F. The Chairmanship would rotate, every two years for example, among each of its members. The Board of Directors would decide on the organization and administration of the E.R.F., would approve the accounts and decide on the appropriation of results.

## 2. An executive Committee

Owing to the specific nature of its powers and to the role that it would come to play directly in the markets, the E.R.F. would have a permanent Executive Committee whose members would be selected by the Committee of Governors solely on the basis of competence.

This Executive Committee would be of a small size, consisting of three or four members who would have direct responsibility for the different departments of the E.R.F..

3. **Two committees** would be given the task of supervising the currency and monetary policy spheres and, where appropriate, making recommendations. These organs, inspired by the "Federal Open Market Committee", would report regularly to the Committee of Governors and, in the framework of a more active "monitoring", would recommend appropriate action in the field of exchange rates and interest rates.

The members of these two committees (a Foreign Exchange Committee and a Monetary Policy Committee) would be appointed by the Committee of Governors from among its own members and those of the Executive Committee of the E.R.F., with the possibility of co-opting one or two outside personalities. Their term of office should be long enough to ensure continuity of action (five years minimum).

### C/ Internal organization

Initially, the E.R.F. would comprise :

- a) a Foreign Exchange and Reserves Management Department,
- b) a Monetary Policy Department.

Subsequently, its structure would be modified in order to incorporate the powers of the EMCF.

### D/ Location

The questions of where to locate the E.R.F. is obviously a difficult one and should be treated as a political matter. Before reaching a decision, it might be worth considering entrusting the management of the E.R.F. to each of its members in turn. However, this kind of organization would diminish the public impact of the Fund and would encounter very serious operational obstacles.

Another solution, initially, would be to locate the E.R.F. temporarily in Basel, where the Secretariat of the Committee of Governors and the EMCF are already located.

### III - Legal conditions for the creation of a European Reserve Fund

It looks, at first sight, as if the legal foundation of the institution of a European Reserve Fund would have to be the provisions of Article 102 A of the E.E.C.'s founding Treaty, which were introduced by the Single European Act in July 1987. This is because the creation of a new organization with monetary purposes -and its corollary, the abolition of the European Monetary Co-operation Fund (EMCF)- may be regarded as "institutional modifications" and therefore require, according to aforementioned Article 102 A, the Treaty review procedure provided for under Article 236.

The procedure in question would entail, in addition to consultation of the European Parliament and the Commission :

- the calling of a conference of representatives of the Governments of Member States, whose decisions are taken "by common agreement",

- ratification of the proposed amendments by all Member States "in keeping with their respective constitutional rules". In principle, this provision implies -although there is no explicit mention of this point in Article 236- approval of the aforementioned amendments by the national Parliaments (1).

Presumably it would be desirable to secure Parliamentary ratification of a document that would lay the legal foundations for carrying the process of monetary integration through to its conclusion. In other words, the document should provide not only for the initial steps sketched out in this note, but also for the subsequent stages leading to economic and monetary union and to a European Central Bank. It would be made clear that each stage would require the prior consent of the Member States.

One of the important questions that should be dealt with will refer to the relationships between the European Reserve Bank and the political authorities in charge of the definition of the exchange parities and the main orientations of the economic policy of the Community. In this regard, the role of the Council of Ministry appears to have to be determining.

The final concept of monetary union is to be dealt with in another note, requested by the President, Mr. Delors, from Mr. Thygesen.

Legal aspects of the Treaty, and the articulation of the different phases with parallel progress to be achieved in fields other than the monetary one, will be worked out by the rapporteurs in the light of the Group's discussions.

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(1) The Article 236 procedure was used in 1986 for the adoption of the Single European Act.