
Secretariat

MAIN ISSUES RAISED BY A POSSIBLE
ASSOCIATION OF THIRD COUNTRIES WITH THE EMS

The discussions by the experts (see Report No. 68 of the Dalgaard group), the Alternates and the Governors on the issues raised by a possible association of third countries with the EMS has revealed differences of views and the necessity to clarify various aspects. The Alternates have been invited to carry out this further study which might focus on the following points.

1. What does association with the EMS mean?

Association with the EMS by third countries means, in the first instance, participation in the EMS exchange rate and intervention mechanisms. This definition results from Article 5.2 of the Resolution of the European Council of 5th December 1978 (1978 Resolution) which stipulates that "European countries with particularly close economic and financial ties with the European Community may participate in the exchange rate and intervention mechanism". It was adopted by the group of experts as a starting point and appears to be also in the mind of those countries which have recently shown their interest in association with the EMS (see the Austrian Aide Mémoire dated 7th February 1990 and the Norwegian non-paper dated September 1989).

According to the spirit and letter of the 1978 Resolution, participation in the EMS exchange rate and intervention mechanism by an associate member would essentially entail:

- formal and mutual exchange rate commitments in the form of a bilateral grid with fluctuation margins of, in principle, $\pm 2.25\%$, as well as possibly ecu central rates; these rates are fixed, and possibly adjusted, subject to mutual agreement by a common procedure which will comprise all countries participating in the EMS exchange rate mechanism and the EC Commission;

- compulsory interventions in participating currencies at the fluctuation margin without any limitation in amount;
- very short-term financing facilities designed to facilitate interventions in participating currencies.

In contrast, association would not entail:

- inclusion of the currency of the associate member in the ecu basket; the calculation of an indicator divergence for the associate currencies, if it were calculated at all, would be based on a zero weight;
- participation in the creation of official ecus by way of revolving swaps of gold and dollars with the EMCF: the 1978 Resolution considers this as an element of the exchange rate and intervention mechanism, but confines participation to "Member States";
- participation in the decision-making process concerning the rules and procedures of the EMS.

2. Safeguards

The possibility of an association of third countries was included in the 1978 Resolution on the EMS, mainly to enable Norway to continue an association with the new Community exchange rate mechanism. Since the inception of the EMS in March 1979, this possibility has not been used, while during this period the EMS has developed considerably and has become a much more integrated and ambitious system.

Under these circumstances, safeguards need to be established against the risk that association:

- would constitute a factor of instability for the EMS;
- would harm the transition to the further stages of EMU which will imply a progressive extension of common decision-making in the monetary field and of closer co-ordination in the economic field.

Three kinds of safeguards might be examined:

- criteria for selection;
- participation in arrangements for policy co-ordination;
- measures against interference in the Community decision-making process.

2.1. Criteria for selection

The three main economic criteria proposed by the experts in Report No. 68 (see top of page 5) have generally been considered useful and necessary by all central banks. Some of them also think they are sufficient, at least at the outset; others argue that association with the EMS by third countries is only conceivable in the context of a move towards full membership in the Community. Thus, in their mind, association would be an interim stage for a country which has, in principle, been accepted as a member of the European Community but whose membership has not yet entered into force.

The basic divergences of opinion may reflect the following considerations:

- For some central banks, only membership in the Community ensures sufficiently strict economic policy commitments to shield the EMS from destabilising factors. For others, the required firmness of policy commitments is not related to membership in the Community.
- Some central banks appear to see a contradiction between monetary integration in the Community in the course of the further stages of EMU and association with the EMS by countries which would not have the same objectives. Others think that monetary integration in the Community can nevertheless progress or may even be enhanced if it were to take place in a wider environment of stable exchange rates.

2.2. Participation in arrangements for policy co-ordination

Community countries have set up a number of arrangements for mutual consultation which are more or less closely related to the EMS. First, there is the "monitoring" organised by the Committee of Governors which examines:

- compliance of member states' exchange rate and monetary policies with the spirit of the Basle/Nyborg Agreement;
- the conformity of monetary policies with the aim of convergence of fundamentals and policies in the Community,

and involves the Governors, the Alternates and experts in formal meetings and teleconferences.

Second, a "multilateral surveillance" is carried out by the Ministers of Finance in official Council sessions and in the informal meetings with the central bank Governors; the exercise is essentially prepared by the Monetary Committee.

How vital are these consultation procedures for the process of policy co-ordination and thus the functioning of the EMS exchange rate mechanism? Conversely, what are the obstacles to participation of the associate members in those consultation procedures which are directly related to the EMS?

2.3. Protective measures against interference with the Community decision-making process

There appears to be agreement on the principle that associate members should not interfere in the Community decision-making process in respect of:

- the rules and procedures of the EMS;
- further steps towards monetary integration in the Community.

Compliance with this principle might be achieved in several ways which, however, have to be consistent with other principles:

- introducing a clear distinction, in the existing consultation mechanisms, between matters which concern the current operation of the EMS (which could be discussed with associate members) and other issues (reserved for Community members);
- setting up ad hoc consultation mechanisms designed to link the EMS as a whole with the associate members.

Would the issue be less delicate if association were only an interim stage for a country which has, in principle, been accepted as a member but whose membership has not yet entered into force?

3. Realignments

The realignment issue raises several questions:

- May an associate country trigger a realignment?
- May an associate country block a realignment among the Community members of the EMS exchange rate mechanism?
- How should the associate countries be introduced in the realignment procedure?

3.1. If it is the common understanding that ecu central rates and the bilateral parity grid for all ERM currencies (Community or non-Community members) can only be changed by mutual agreement, it might be difficult not to permit an associate member country to trigger a realignment. Indeed, it appears to be hardly feasible to lay down in the terms and conditions of

association the principle that the associate member would only have the right to adjust its exchange rate relationships vis-à-vis the other members on the occasion of a realignment triggered by a Community country or to withdraw from the system.

3.2. In respect of the second issue, the Dalgaard group established the principle that the associate members should not be able to block a realignment. However, are the Community members also prepared not to block an adjustment of the associate currencies' central rates? If yes, would this mean an erosion of the principle of mutual agreement. Conversely, if Community members felt entitled to block a realignment of the associate members, this would mean that Community members would claim a right which they were not prepared to grant to the associate members.

3.3. The answer to the question mentioned in 3.2 above also has implications for the question of the realignment procedure. Some experts of the Dalgaard group were in favour of a two-stage procedure which would hardly be acceptable to the associate members if they insisted upon the principle of equal rights and obligations. In addition, would such a procedure be feasible on practical grounds?

4. Legal aspects

The Dalgaard group pointed out that changes in Community legislations through amendment to the Council Regulations relating to the EMCF would only be needed if:

- association included book-keeping by the EMCF (a precondition for the multilateralisation of balances resulting from VSTF operations with associate EMS members);
- associate members participated in the creation of ecus through swaps with the EMCF.

In addition, participation of the associate members would require amendments to the Council Decision on the realignment procedure; these amendments, however, could be made more easily than the changes in the Council Regulations relating to the EMCF which are based on Article 235 of the Treaty and thus necessitate unanimity in the Council and the consultation of the European Parliament.

To what extent would it be possible and/or opportune to implement association without seeking a change in Community legislation?