

Ministerialdirektor
Dr. Horst Schulmann
BUNDESKANZLERAMT

SECRET

53 Bonn 12, den 19. Mai 1978

Postfach
Fernruf 56 ...2400
oder 561 (Vermittlung)

Mr. Kenneth Couzens
Second Permanent Secretary
of the Treasury
Parliament Street
London SW 1 P 3 AG

Per Eilbote

Personal

Dear Ken,

Please find attached a summary of our recent discussions in Paris. I hope it is a fair record of what was said and a useful basis for further discussions.

I look forward to seeing you in Washington next week.

Best regards,

Horst

Possible Elements of a New European Exchange Rate Scheme

1. The elements of such a scheme can be discussed under the following headings:

- (a) margins for intra-Community exchange rate changes,
- (b) Community exchange rate policy vis-à-vis third currencies,
- (c) currencies of intervention,
- (d) financial mechanisms to support interventions,
- (e) role of EUA as a reserve medium,
- (f) supplementary financial mechanisms.

These points will be taken up in turn in the following paragraphs.

2. It is probably useful to think of such a scheme as an evolutionary one, i.e. not all participants need be subject to the same rules from the outset; it is desirable, however, that all Community member countries participate in the scheme from the very beginning. Although a two-tier "snake" is technically feasible it is politically not very attractive. In view of the relatively long time that some European currencies have spent outside the snake, a gradual, flexible approach to greater intra-Community exchange rate stability seems appropriate, however. Current exchange rates between snake and non-snake currencies in the Community appear to be roughly in equilibrium; the question is how tenable they are over a six or twelve month period. A

...

greater degree of flexibility may be desirable for the non-snake currencies. This flexibility might result from wider margins of intervention or from more frequent changes of central rates (which, incidentally, should, in the future, be expressed in terms of the EUA). If the former course were chosen this would probably mean narrower margins for the current members of the snake and wider margins for the members, say 2.25 percent for the former and 4.5 percent for the latter. It is, however, far from certain that wider margins of intervention will make life easier for the currency managers; it may very well be that "Bretton Woods" margins are just as easily defensible as much wider margins.

Nevertheless, it seems to be a fair conclusion that a certain amount of 'tatônnement' will be necessary during the start-up phase of a new exchange rate scheme, with the understanding that margins would be progressively narrowed. Such 'tatônnement' would be preferable to a (devaluation) discount on entry which, in any case, might not be acceptable to some of the other members participating in the scheme.

- I am told
this means
"gossiping"
standards
error,
liberalism
etc.*
3. A joint Community exchange rate policy vis-à-vis third currencies has been high on the agenda for a long period of time. The primary purpose of such a policy should be to keep intra-Community exchange rates together. It would not be anti-American; there is no interest in artificially depressing the value of the dollar. However, the objective

of such a policy is not to oppose fundamental market factors; there is no way how these factors can be stopped from operating in the long run. But there certainly is room for coordinated interventions in the face of erratic movements in bilerateral exchange rates.

A body like FECOM could be charged with the coordination of such interventions which would, however, continue to be undertaken by the central banks of participating countries. This would leave open the question whether and how the costs and benefits of such interventions would be shared among the participants. It is also conceivable that FECOM itself might be entrusted with the task of carrying out the interventions, with central banks acting as fiscal agents; in this case it would be clear that intervention would be on joint account. A further possibility that might be envisaged is for FECOM to conclude swap agreements with monetary authorities outside the Community.

4. A good deal is to be said in favour of the rule that intra-Community interventions should be in Community currencies. It would also be more normal for participating countries to use the EUA as a means of settlement. FECOM could issue EUAs as the counterpart of the deposition of national currencies with the institution; this would, however, increase the total volume of international liquidity. In a more far-reaching scheme FECOM might also issue EUAs against US dollars held by participating countries, thus reducing the dollar contents of national reserves; such a scheme

would not increase the total volume of international liquidity but raise other questions, particularly if not accompanied by a pooling of reserves.

5. While the existing financial mechanisms seem to be sufficient for "normal" intervention needs, there may be a case for a further increase of these mechanisms in order for central banks to be able to cope with special cases such as the "May events". This would in particular call for an increase of the short-term facility and perhaps also for an extension of maximum maturities under this facility. A further increase in the medium-term facility appears less urgent.
6. It is unlikely that the EUA will become an international reserve asset in the near future. Such a role could, however, emerge over time as the EUA assumed new functions within the Community, e.g. as a unit in which private and public capital transactions are denominated. It is an open question whether the Community should actively seek such a rôle for the EUA and whether competition between reserve currencies is likely to increase the stability of the international monetary system.
7. The EIB is a useful supplementary financial instrument. Its role in the overall resource transfer within the Community is,

~~SECRET~~
5 -

however, a limited one. This role could be enhanced if the EIB were to grant loans at below market rates; such interest subsidies would be granted on country grounds, not on project grounds.