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PRIME MINISTER

EMU

I have been considering how we should approach the EMU IGC.

Economic Union

2. On the economic side, there are two issues which could cause us difficulty.

- (i) The first relates to the proposal for binding rules on budgetary deficits. I find it difficult to conceive of circumstances in which this would be acceptable to Parliament, since its effect could be to determine national levels of taxation or public expenditure. So far, we have resisted the proposal with some success: only Germany and Holland continue to press for it and its absence from the Conclusions of the Rome European Council augurs well for the IGC. However, if the negotiations do become deadlocked here, one possible way out is to accept that countries with grossly bad economic policies (including excessive deficits) should lose their entitlement to structural fund receipts, a measure which might well be justified in its own right. We are doing further work on this possibility.
- (ii) It seems increasingly likely that some Member States will press for greater tax harmonisation. We will need



to resist such proposals and to continue to argue for a market based approach.

3. The rest of the economic side should pose less problems. We are already committed to rules against bail outs and the monetary financing of budgetary deficits. We also accept binding procedures for multilateral surveillance.

Monetary Union

4. On the monetary side, the main issue is our attitude to a single currency, managed by an independent central bank conducting a single monetary policy: in short, Stage 3.

5. The meeting of the European Council in Rome showed that the other eleven Member States are determined to press ahead with a Treaty embodying a Stage 3. That is my impression too from the discussion at the Milan Informal ECOFIN, although there are growing disagreements among the Eleven about the precise form of the Stage 3. As you know, our legal advice is that it would be possible, though technically difficult, to formulate a Treaty of Eleven embodying Stage 3. I believe that our partners would be reluctant to do that especially if we had made clear, at a suitable stage in the negotiations, that we would be unwilling to recommend the outcome of the Political Union IGC to Parliament without a satisfactory outcome of the EMU IGC. Even so, I think we have to assume that the Eleven would be unwilling to accept a permanent block by one Member State on their aspirations for full monetary union in the Community and that in the end they would agree among themselves a Treaty of Eleven.

6. The effects a Treaty of Eleven are not clear cut. The outcome would depend on how successfully the eleven Member States pursued EMU; how successfully the UK, outside the Eleven, pursued its own monetary and fiscal policies; and how - and how quickly -



the private sector, including financial markets, perceived the results. There is nothing inevitable about our ending up at the very negative range of possible outcomes. But a Treaty of Eleven would almost certainly weaken our negotiating position in other areas of EC business. And even though many of the consequences of such a break with the other Eleven would not be felt for some years, the immediate effects in 1991 on financial markets and inward investment could be distinctly adverse. The political consequences of such an appearance of isolation could also be serious.

7. So I conclude that we need to do what we can to avoid a Treaty of Eleven subject to what I regard to be our overriding objective for the monetary side of EMU. This is that we must avoid any pre-emption of Parliament's right to decide whether the UK should move to a single European currency. Quite what this might mean in practice is discussed in paragraphs 9-13 below. Subject to that overriding priority, we also need to work for the following objectives:

- (i) For political and economic (convergence) reasons, it is in our interests for Stage 2 to last as long as possible so that any decisions on moves to Stage 3 are delayed. This requires that Stage 2 should have a substantial content. And there should be objective criteria for the move from Stage 2 to Stage 3.
- (ii) To the extent possible Treaty arrangements should maximise the possibility of all Member States moving forward, if not together, in a common framework.
- (iii) The introduction of a common currency in Stage 2 would be a useful element both because it would add substance to Stage 2 and because it would ensure that all 12 remained involved in managing the common currency



even if a group of countries moved ahead of the others into full union.

- (iv) The constitution etc for the Stage 3 Central Bank (price stability, accountability, independence etc) should be as satisfactory as we can make it.

8. It is clear that - while interest and support is still there - the British proposals for a European Monetary Fund and hard ecu are unlikely to be accepted as they stand. There is increasing interest in the idea of a common currency in Stage 2. But it is believed that our proposals are designed to anchor the IGC in Stage 2, and to prevent any member states moving forward to full currency union. A treaty which allows only for Stage 2 is simply not negotiable. I believe we need to make clear that the arrangements we propose for Stage 2 are capable of being developed into full currency union arrangements - for those member states who choose it - without further treaty change.

9. I believe that if we are to meet our priority objective, we will need to secure in the Treaty some form of opting-in mechanism (though there are strong presentational advantages in not referring to it as "opting-in"). For the purposes of analysis, the main opting-in options can be classified as set out below. The options are:

I. Opting-in as to time.

IIA. Opting-in as to principle.

IIB. Opting-in as to principle: developing the UK proposals.

10. In practice these distinctions might become blurred in discussion in the IGC. It would probably be tactically helpful for us in that gathering to leave it obscure for as long as



possible whether our position was reserved on the principle or on the timing for the UK of a move to Stage 3.

Option I: Opting-in as to Time: Unlimited Derogation for the UK

11. Under this option, the UK would accept the principle of moving to a single currency, but left it to each country when to make such a move, perhaps subject to conditions of convergence. This would be fairly easily negotiable; indeed it is what most Member States expect to be the outcome. Though perhaps not impossible, it would be difficult to reconcile with our line hitherto: the argument would be that this option allowed the UK to stay outside a single currency indefinitely and that by this means a future Parliament's right to choose had been fully protected. But others would argue that we had sold the pass in accepting the principle of a single currency and it is not clear that it would be acceptable in the Party or the House.

Option IIA: Opting in as to Principle to Stage 3

12. Under this option, the Treaty would contain an opting-in clause on a single currency in Stage 3. The UK could choose whether and when it exercised that right. This approach would avoid an early overt rupture with the other Member States, delaying, perhaps for some years, difficult decisions. We cannot be sure that the rest of the Community would accept this approach, but I believe they would. It would, no doubt, help if we were to accept others' definitions of full EMU as a single currency, while retaining discretion on whether to move to it. This option would provide some assurance to those of our Parliamentary colleagues suspicious of EMU. But others, for example foreign investors and the City might believe it presaged our distancing ourselves from the Community. If other Member States knew that we were seeking an opting-in as to principle option, our ability to influence the content of the Stage 3 arrangements in the IGC could be reduced.



13. But if Stage 2 were empty, I believe that the pressure for us to join Stage 3 by opting in would soon become difficult to resist, whether or not we thought it desirable. There would be a wide gulf between those who had opted in, and those who remained outside. This option runs the risk of upsetting both sides of the domestic argument: those who fear a two-tier Europe with us on the lower tier; and those who believe that without the bastion of a substantial Stage 2 we will soon be bounced into a single currency, against our better judgement.

Option IIB: Opting in as to Principle to Stage 3: Developing the UK proposals

14. This option, which would also preserve the UK's discretion whether to move to a single currency, would spell out what is meant by the statement about the hard ecu developing into a single currency "if peoples and governments so choose". It would enshrine for Stage 2 our common currency hard ecu/EMF proposals. But it would permit countries wanting to move to Stage 3 and a single currency (ie the hard ecu) to do so, but to allow any country which rejected a single currency to remain in Stage 2 and to retain its national currency while continuing to use the hard ecu as a common currency.

15. Under this option, signing the Treaty would commit Member States only to Stage 2: the move to Stage 3 by a Member State would only be triggered by a future decision of its national parliament. This is the option which best meets our objectives. It is not clear whether this approach would be negotiable, particularly in view of German and Dutch hostility to the hard ecu/EMF approach. It also raises difficult technical issues. One is the governance of the monetary institution in Stage 3 when the EMF would become a true Central Bank for the Member States which had adopted the hard ecu as the single currency. But there



is a genuine and widespread desire to see arrangements which enable us to stay on board, and we should not underestimate the strength of our hand.

The Form of the UK Reserve in the IGC

16. Hitherto we have taken little part in the discussions in ECOFIN and the Monetary Committee on the details of Stage 3 because we have denied that that stage was either necessary or desirable. If we continue to take this line in the IGC, we will have very little influence on the Stage 3 arrangements. We therefore need to consider whether we could devise a negotiating reserve which would protect us from domestic criticism while enabling us to participate in those discussions. One possible form of words for such a reserve is set out below. We need the same broad message to both domestic and IGC audiences, though that for the IGC - perhaps at a full January session - could be shorter:

"The UK is taking a constructive role in the IGC discussions. We have already put on the table proposals which would allow early progress towards further integration and convergence. While we have made clear our position that we are not able to make a commitment to the principle of a single monetary policy and a single currency, we recognise that our proposals would be able to develop into a single monetary policy and single currency as governments and peoples choose; and on that basis we have participated in full in the EMU discussions. We also recognise the success that the Community, acting together, has had in the past in achieving a consensus on practical decisions. We hope and expect that the IGC will be able to reach an agreement acceptable both to us and to our Community partners. The form and content of such an agreement is a matter for the IGC. Its acceptability



to all participants, including ourselves, can only be judged at a much later stage of the negotiations.

Subject to this reserve, we will negotiate on all the texts which will be laid before the IGC."

More work needs to be done on this form of words, but it sets out the general lines of what we might say.

Statutes of the EMF

17. There has been considerable technical interest in the Community in our hard ecu/EMF ideas, and some Delphic hints of interest from Beregovoy, but only Spain has fully incorporated the approach into their proposals, as a transition to Stage 3. But if our ideas are to be kept on the table during the discussion of the legislative text in the IGC, I think that we will have to table our own legislative text establishing the EMF as a focus for discussion on the substance of Stage 2. Drafts are attached which have been prepared under the Financial Secretary's supervision. Some particular points on the drafts:

- (i) The text does no more than provide for the establishment of the EMF and hard ecu in the form that we have advocated. It does not include evolutionary provisions which, by a decision of the Council of Ministers or the Fund Board, would permit the arrangements to evolve, if governments so decided, into a fully fledged Central Bank managing a single currency. We have text available which would allow this to happen without further treaty amendments. If our text is published I would propose to make clear that it would be possible to adapt the text to make it evolve in this way.

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- (ii) To the extent possible the text has been modelled on provisions of the Central Bank Governors' text for the ESCB so as to maximise acceptability. Inevitably our sponsorship of the provisions for an EMF would be taken as our acceptance of them for an ESCB.
- (iii) As you know, there is a row brewing between the French and the Germans on the extent to which new monetary institutions would have to operate independent of Governments. I believe that we can safely avoid taking sides on this delicate issue for the time being; and the text therefore suggests alternative formulations in Article V. The commentary to that Article explains the differences. If anything, this should help to stir up the Franco-German dispute. (The commentary would of course not be published with our text, though some explanatory notes would no doubt be helpful.)

But we should recognise that if we did accept full independence for the EMF, it would be difficult to persuade others that it should cease to be independent when it evolved into a central bank.

- (iv) Article IX sets out the arrangements for the accountability of the EMF. Paragraph 5 of that Article would lay on the EMF obligations vis-a-vis national parliaments. This would break new ground and would, we understand from the Foreign Office, go considerably beyond our present thinking about the general role of national legislatures in EC decision-making, a subject which is under discussion in the Political Union IGC. The FCO are therefore reluctant to table such a paragraph, at least at this stage. My concern is that we need to flag up in some way when publishing our text that we do not rule out the Treaty providing for



national parliaments to have a role in accountability for the Fund. Unless we do this, we would find it harder to argue that similar provisions should apply to the ESCB, if that is what we choose to do.

18. I believe that we should publish the text. I have not decided when this should be done. But we would need to be ready to table it at the first meetings of the IGC on 15 December if the Presidency/Commission table their own drafts. Having our text on the table would increase the chances of our securing early discussion in the IGC of Stage 2. But we can decide this in the light of our discussion.

Conclusions

19. My preliminary conclusions from these complex issues are as follows:

- (i) We should table a reserve broadly on the lines described in paragraph 13 above. This should give us freedom to negotiate on all aspects of the Treaty in the IGC but in a way which protects us to the extent possible from domestic criticism. Our aim should be to give the other Member States the impression that we might in the end sign up to an amending Treaty, including Stage 3 elements, but leave them uncertain as to precisely what we would accept.
- (ii) At the same time, we should maintain our opposition to an imposed single currency and insist on Parliament's right to decide on any move by the UK to a single European currency. We would not spell out what this meant, at least in the initial stages of negotiation.

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- (iii) We should press hard our common currency approach, in particular by tabling draft statutes and indicating in a general way that we would be ready to see Treaty provisions which would provide for the evolution of our proposals in the direction of Option IIB.
- (iv) We should keep in mind during the negotiations the three forms of opting-in. Option IIB looks the best from our point of view. Officials should start work now on devising, on a contingency basis, language which we could table at a later stage for converting the texts before the IGC into the sort of opting-in Treaty which we would be able to accept.
- (v) We should ask officials to let us have urgent advice on the main elements of the Stage 3 arrangements (independence of the ESCB, responsibility for exchange rate policy, accountability etc) as a basis for settling our negotiating line in the IGC. They should also provide urgent advice on the arrangements for Stage 3 under Option IIB and, particular, the governance of the central monetary institution.
- (vi) We should try, without appearing overtly dilatory, to spin out the discussion as long as possible and, subject to any further developments, should not be ready to take a final view on the outcome of the EMU IGC separate from decisions on the Political Union IGC.

The Rome European Council and the Rome Meetings of the IGC

20. It looks unlikely that EMU will feature significantly at the second Rome European Council. Nor are there likely to be negotiations, so we are told, at the formal opening of the IGC which you will attend. The Italian Presidency told us that the

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first working session on 15 December would be devoted to organisational issues. There I suggest that I try to secure agreement that our Stage 2 ideas should be considered at an early stage in the IGC discussions. It is also likely to be in our interests to support the Luxembourgers in any dispute against the Italians in their efforts to retain control over the management of their own Presidency.

21. You will wish to consider how to involve Cabinet colleagues in these issues. One possibility is for me to put the paper to a small group of colleagues which would consider the sort of issues described in this note and then for there to be a more general report to Cabinet which would endorse, in broad terms, our negotiating position.

22. I should be glad to discuss these issues with you.

I am sending a copy of this minute to the Foreign Secretary and to Sir Robin Butler.

J. Gieve

J. G.

[N.L.]

11 December 1990

[Approved by the Chancellor]

P-3

DRAFT TREATY ARTICLES FOR A EUROPEAN MONETARY FUND

Article I

A European Monetary Fund is hereby established with legal personality.

The members of the Fund shall be the central banks of the Member States.

The Fund shall be administered by a Governing Board and an Executive Board.

[The Statute of the Fund is laid down in a Protocol annexed to this Treaty.]

Commentary

1. This article establishes the EMF. It assumes that central banks will be members of the Fund, suggesting a degree of separation of the body from the Member States' governments. (The assumption underlying the article is that the initial working capital of the EMF would be provided by the central banks, not by the Member States.)

2. An alternative formulation would involve the Member States themselves being members. But this could be a source of tension were the EMF taking decisions which conflicted with policy at a national level. It would also conflict with the central bank Governors, approach and would be unlikely to get much support within the Community.

Article II

1. The overriding objective of the European Monetary Fund shall be to promote and maintain price stability in the Community as part of the progressive realisation of Economic and Monetary Union.

2. Without prejudice to the objective of price stability, the Fund shall support the other economic policy objectives of the Community.

3. In exercising its functions the Fund shall at all times act consistently with free and competitive markets.

Commentary

This article sets out the primary and secondary objectives of the EMF, and is closely modelled on the provisions of the relevant central bank Governors' draft Statute for the ECSB. The reference to 'other economic policy objectives of the Community is designed to make it more acceptable to other Member States.

Article III

1. For the purposes set out in Article II the European Monetary Fund shall have responsibility for the issue and management of a common currency which shall be called the [hard ECU].

2. The Fund shall undertake such additional tasks as the Council, acting unanimously and after consulting the Monetary Committee, may decide. [The Commission may recommend to the Council additional tasks to be undertaken by the Fund.]

3. Decisions of the Council under paragraph 2 shall lay down any measures necessary to give effect to, or facilitate the achievement of, additional tasks conferred on the Fund. Such measures may confer on the Fund powers for the implementation of rules laid down by the Council.

4. [The provisions of this Article are without prejudice to the existing powers of the Member States to issue and manage their national currencies.]

Commentary

1. This article sets out the tasks of the EMF. It focuses on the primary task of issuing and managing the common currency.

2. Subsidiary tasks, such as managing the ERM and coordinating exchange rate intervention, would be left to subordinate legislation adopted by the Council. Paragraphs 2 and 3 therefore provide the EMF with a degree of evolutionary capacity. But the unanimity requirement means that the UK could still exercise a veto on proposed additional tasks. And, unless the article was expanded, further treaty amendment would be necessary to enable the EMF to evolve into a fully fledged central bank.

3. Paragraph 4 provides an additional line of defence should Ministers consider it necessary; its inclusion would have the effect of entrenching Member States' existing competence. It would

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have to be disapplied, by separate decisions of all the Member States, before a single monetary policy could be adopted.

Article IV

[Without prejudice to the powers of the Commission and the Council with regard to the negotiation and conclusion of agreements between the Community and third countries or international organisations,] the European Monetary Fund shall be entitled to establish relations alongside the Member States with central banks and financial institutions in third countries and, where appropriate, with international organisations.]

Commentary

A major issue for the IGC will be whether responsibility for EC monetary relations with third countries and international institutions (IMF etc) should lie with the monetary institution or with the Council or some other political body. The Central Bank Governors were unable to agree on this issue in drafting the ESCB statutes; there may be deep divisions in the IGC. But we recommend that the UK should table a text as above. The EMF establishing "relations" with entities in third countries would not preclude Member States from doing the same.

Article V

ALTERNATIVE 1

1 In exercising the powers and performing the duties conferred on them by this Treaty the members of the Governing Board and Executive Board of the European Monetary Fund shall be completely independent and shall neither seek nor take instructions from any Community institution, national government or any other body or person.

2. Member States and the institutions of the Community shall respect the independence of the members of the Governing Board and Executive Board of the Fund and not seek to influence them in the performance of their duties.

ALTERNATIVE 2

1. The provisions of this Treaty are without prejudice to the existing relationships between national central banks and the governments of the Member States save to the extent that changes are necessary to ensure consistency with the provisions of the Treaty and the Protocol.

Commentary

1. The drafting here deliberately provides 2 alternative approaches. It is envisaged that both would be published, making a virtue of setting out a choice of approaches.

Alternative 1 establishes the independence of the EMF's board, and mirrors a comparable provision in the draft ESCB Statute. However, unlike the ESCB Statute, there is no requirement that members of the governing bodies of national central banks be independent. A firm declaration of independence may be essential to attract German support.

This version of the article could be included in either the Treaty or the Statute. The attraction of the former is greater prominence.

Alternative 2 is a deliberately Delphic text whose purpose is to underline the right of Member States to refrain from conferring independent status on their national central banks. This might, for example, be acceptable to France. But this formulation would leave unresolved the independence or otherwise of members of the Governing and Executive Boards, a question which is addressed squarely by Alternative 1.

Article VI

1. The European Monetary Fund shall participate in the European Monetary System and the [hard ECU] shall be a participating currency in the exchange rate mechanism of the System. Any alteration to the rules of operation of the exchange rate mechanism shall require the consent of the Fund.

2. Bilateral central rates for the [hard ECU] against the other currencies participating in the exchange rate mechanism shall be established by mutual agreement between the Fund and the Member States.

3. The Fund shall neither seek nor agree to a reduction in the bilateral central rate for the [hard ECU] against any of the other currencies participating in the exchange rate mechanism.

[4. The Fund shall not issue liabilities, by way of deposit or otherwise, except in exchange for national currencies of the Member States].

5. The national monetary authorities of the Member States shall be obliged to repurchase excess quantities of their national currencies held by the Fund.

[6. The national monetary authority of each Member State shall guarantee the value, expressed in terms of the [hard ECU], of its national currency held by the Fund.]

7. The Council, acting unanimously after consulting the Monetary Committee and the Committee of Governors of the central banks of the Member States, shall adopt the measures necessary to give effect to this Article.

Commentary

1 This article sets out the EMF's obligations in relation to the common currency. Subordinate legislation adopted by the Council would

- enable the Fund to decline to accept excessive quantities of a particularly weak national currency
- provide rules for deciding what quantity of a national currency should be regarded as excess for the purposes of the repurchase obligation (including the possibility of a discretionary grey zone)
- amplify the nature and extent of the guarantee requirement (if included), and
- enable amendments to be made to existing EC legislation on the EMS (currently based on Article 235/EEC) to reflect the participation of the hard ECU in place of the basket ECU.

The alternative of leaving the adoption of subordinate rules to the EMF's Governing Board has been rejected, in view of the political sensitivity of the obligations imposed on the Member States by this article.

2. Paragraph 6 is in square brackets to reflect its position as an option, not a requirement, in the UK paper to the Monetary Committee.

3. It is assumed that the Committee of Governors would continue to exist as at present (but with the EMF represented on it). The EMF would also be represented on the Monetary Committee; Article 105/EEC would have to be amended in this respect.

4. As drafted, this Article would not entitle the EMF to refuse to accept altogether a currency which was not in the narrow band.

Article VII

1. If the Executive Board of the European Monetary Fund considers that a Member State or the central bank of a Member State has failed to fulfil an obligation under this Treaty or under the Statute of the Fund, it shall deliver a reasoned opinion on the matter after giving the Member State or the central bank concerned the opportunity to submit its observations.

If the Member State or the central bank concerned does not comply with the opinion within the period laid down by the Executive Board, the latter may bring the matter before the Court of Justice.

2. The Court of Justice shall, within the limits hereinafter laid down, have jurisdiction in disputes concerning:

(a) measures adopted by the Governing Board of the Fund. In this connection, any Member State, the Commission or the Executive Board of the Fund may institute proceedings under the conditions laid down in Article 173;

(b) measures adopted by the Executive Board of the Fund. Proceedings against such measures may be instituted only by Member States or the Commission under the conditions laid down in Article 173.

3. National central banks and the Fund shall be required to take the necessary measures to comply with judgments of the Court of Justice in proceedings instituted pursuant to this Article.

Commentary

1. This article provides for the EMF to be subject to judicial review. Were the EMF a Community institution, much of the

framework for judicial review would be provided by existing articles in the Treaty.

2. The main points to note about this article, which adapts for use in the present context the neat approach adopted by Article 180/EEC in relation to the EIB, are that it gives a role, in enforcement matters, to the Governing Board or Executive Board of the EMF and makes national central banks liable to infraction proceedings. Failure on the part of a Member State or a national central bank to perform its obligations under the Treaty or the Statute of the EMF could be challenged by the Executive Board under paragraph 1. In addition, measures adopted by the Governing Board or the Executive Board which failed to comply with the provisions of Articles I to X (or other provisions of the Treaty or general principles of EC law) could be challenged under paragraphs (a) and (b).

Article VIII

Article 22 of the Protocol on the Privileges and Immunities of the European Communities shall apply to the European Monetary Fund as it applies to the European Investment Bank.

Commentary

This article deals with the privileges and immunities of the EMF and its staff by putting it on the same footing as the EIB. Provision along these lines is needed because it is assumed that the EMF would not be a Community institution.

Article IX

1. The Chairman of the Governing Board of the European Monetary Fund shall be invited to participate in meetings of the European Council and the Council when matters relating to the objectives and tasks of the Fund are discussed.

2. The President of the Council and a member of the Commission may attend meetings of the Governing Board of the Fund. They may take part in the deliberations of the Board but shall not be entitled to vote.

3. The Fund shall draw up monthly reports on its activities for presentation to the Council, on which the Monetary Committee may express an opinion.

4. The Fund shall draw up an annual report on its activities. The Chairman of the Governing Board shall present the annual report to the European Council, the Council and the European Parliament.

5. [It shall be the duty of the Fund to keep the Parliaments of the Member States fully informed of its activities. To this end the Fund shall, in particular, make its annual report available to national Parliaments at the same time as to the European Council, the Council and the European Parliament. It shall be the duty of the Chairman and other members of the Governing Board of the Fund to respond to requests by the European Parliament and national parliaments to account for their governance of the Fund.]

6. To assist in the implementation of Article II.2, the Council shall each year send to the Fund its annual economic report.

Commentary

1. Paragraphs 1, 2 and 4 of this Article reflect the accountability provisions of the draft ESCB Statute in providing for annual reports and participation in meetings.

2. But it is envisaged that the accountability provisions for the EMF might extend substantially beyond the ESCB model; the case for this counter-balance would be particularly strong if it was decided to include Alternative 1 in Article V confirming the independence of the Fund.

3. Hence paragraph 3 provides for a monthly reporting procedure to EcoFin, through the Monetary Committee. This would give the Council a regular opportunity to make its views clear to the head of the EMF, while stopping short of any formal powers of direction.

4. Paragraph 5 above would also lay on the EMF obligations vis a vis national Parliaments. This would break new ground (there is no reference to national Parliaments in the Treaties at the moment) and would go considerably beyond HMG's present thinking about the general role of national legislatures in EC decision-making, a subject under discussion in the EPU IGC. FCO advice is therefore against tabling such a paragraph, at least at this stage. It would be possible to suggest instead a political understanding that the EMF would in practice operate as paragraph 5 suggests.

Article X

If any member of the Board of Governors of the Executive Board of the Fund no longer fulfils the conditions required for the performance of his duties or if he has been guilty of serious misconduct, the Court of Justice may, on application by the Council or the Chairman of the Governing Board, compulsorily retire him.

Commentary

The removal procedure in this article adapts for use in this context the procedure laid down in Article 160/EEC for removing individual members of the Commission.

DRAFT STATUTES OF THE EUROPEAN MONETARY FUND

Chapter 1 - Constitution

Article 1, (A1, A37)

The European Monetary Fund established by Article I of this Treaty (hereinafter called "the Fund") is hereby constituted; it shall perform its functions and carry out its activities in accordance with the provisions of this Treaty and of this Statute.

The seat of the Fund shall be [] [determined by common accord of the Governments of the Member States].

Article 2 (A2, A3)

The objectives of the Fund shall be those defined in Article II of this Treaty and its tasks shall be those defined in, or conferred on it by decision of the Council under, Article III of this Treaty.

Article 3 (A1)

In accordance with Article I of this Treaty the following shall be members of the Fund:

[list of central banks and Institut Monetaire Luxembourgeois]

Commentary

These three articles provide the principal link between the Treaty and the Statute (which would take the form of a Protocol annexed to the Treaty). Much of the detailed substance of the corresponding articles in the ESCB Statute has here been transferred to the Treaty.

CHAPTER II - ORGANISATION

Article 4 (A9)

The decision-making bodies of the Fund shall be the Governing Board and the Executive Board.

Commentary

This assumes the same two-tier structure as that envisaged in the ESCB Statute (for further examination of this point, see comments on Article 7 below). Governing Board is used here in preference to the title "Council" employed in the ESCB Statute because of possible confusion with the European Council and the Council of Ministers.

The ESCB Statute (see especially A8 and A9) is moving towards a structure in which the System is governed by the decision-making bodies of the ECB itself. The above formulation for the EMF may create a presumption in favour of such a relatively centralised form for an ESCB/ECB but it is difficult to see what alternative approach there could be for an EMF that is unitary in nature.

Article 5 (A10, A15) - The Governing Board

- 5.1 The Governing Board shall comprise the President, the Vice-President, the other members of the Executive Board and the Governors of the national central banks. The President of the Council of Ministers and a representative of the Commission may take part in the deliberations of the Council of the Fund but they may not vote.
- 5.2 Subject to Article 5.3 of this Statute, only members of the Governing Board present in person shall have the right to vote. Each member shall have one vote. Save as otherwise provided in the Statute, the Governing Board shall act by a simple majority. In the event of a tie, the President shall have the casting vote. In order for the Governing Board to vote, there shall be a quorum of two-thirds of the members.
- 5.3 Weighted voting shall apply in accordance with the provisions of Article 23 of this Statute. If a Governor is unable to be present, he may nominate an Alternate to cast his weighted vote.
- 5.4 The proceedings of the meetings shall be confidential. The Governing Board may decide to make the outcome of its deliberations public.
- 5.5 The Governing Board shall meet at least ten times a year.

Commentary

It is envisaged that, as in the ESCB Statute, the same chief executive would preside over both the Governing Board and the Executive Board. The title of President is retained here.

In the case of the ESCB Statute it is understood that "present in person" (Article 5.2) may include participation in a teleconference and that, in the absence of a Governor, an Alternate may attend but not vote except as under Article 5.3. Weighted voting (Article 5.3) would apply to decisions concerning capital and the allocation of profits and losses, for which members of the Executive Board would have no votes (see also Article 23 below). Since proxy voting is provided for in such matters, no quorum is set.

Article 6 (All) - The Executive Board

- 6.1 The Executive Board shall comprise the President, the Vice-President, and 4 other members.

The members of the Executive Board shall be selected among persons of recognised standing and professional experience in monetary or banking matters.

No member shall, without approval of the Governing Board, receive a salary or other form of compensation from any source other than the Fund or occupy any other office or employment, whether remunerated or not, except as a nominee of the Fund.

- 6.2 The President shall be appointed for a period of 8 years by common accord of the Member States, after the Governing Board has given its opinion, and after consultation with the European Parliament.
- 6.3 The Vice-President and the other members of the Executive Board shall be appointed, for a period of 8 years [by common accord of the Member States] after consultation with the Governing Board.
- 6.4 [With the exception of the President,] no member of the Executive Board shall hold office beyond the age of 65.
- 6.5 All members of the Executive Board present in person shall have the right to vote and shall have, for that purpose, one vote. The Executive Board shall act by a simple majority of the votes cast. In the event of a tie, the President shall have the casting vote. [The voting arrangements will be specified in the Rules of Procedure.]
- 6.6 The Executive Board shall administer the Fund.

Commentary

Articles 6.2 and 6.3 provide for the appointment of all members of the Executive Board by common accord of the Member States. The ESCB Statute provides for appointment by the European Council (in which the President of the Commission has a voice). As in the ESCB Statute, the President (but not other Executive Board members) would be appointed only after consultation with the EP.

The passage in square brackets in Article 6.4 makes exception for the President alone to hold office beyond the age of 65, as provided in the ESCB Statute.

Article 7 (A12) - Responsibilities of the governing bodies

- 7.1 The Governing Board shall take the decisions necessary to ensure the performance of the tasks entrusted to the Fund under this Treaty and this Statute. The Governing Board shall formulate the policy of the Fund in respect of the [hard ECU] including, as appropriate, decisions relating to intermediate objectives, key interest rates and overall liquidity, and shall establish the necessary guidelines for their implementation.
- 7.2 The Executive Board shall implement the policy of the Fund in accordance with the decisions and guidelines established by the Governing Board.
- 7.3 The Executive Board shall, to the extent possible and appropriate, seek the assistance of the national central banks in the execution of the operations of the Fund.
- 7.4 The Executive Board shall have responsibility for the preparation of the meetings of the Governing Board.
- 7.5 The Governing Board shall adopt Rules of Procedure which determine the internal organisation of the Fund and its decision-making bodies.

Commentary

This Article broadly follows the equivalent Article in the latest draft of the ESCB Statute, which clearly subordinates the Executive Board to the authority of the Council (although the balance of power between the two decision-making bodies of the ESCB is still under active discussion in Basle).

The ESCB Statute requires the Executive Board, when implementing monetary policy, to give the necessary instructions to national central banks and, to the extent possible and appropriate, to make use of the national central banks in the execution of its operations. Article 7.3 here merely requires the Executive Board of the EMF to seek (as appropriate) the assistance of national central banks. This different treatment is employed because of the greater potential for conflicts of interest between the EMF and national central banks in circumstances where a common (HECU) policy co-exists with autonomous national monetary policies. There may, however, be some risk that this might prejudice the modus operandi of any future ESCB (why should a central monetary institution be

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under a greater obligation to use national central banks when there is a single currency and a single monetary policy than when its authority over national authorities is more limited?).

Article 8 (A13) - The President

- 8.1 The President or, in his absence, the Vice-President shall chair the Governing Board and the Executive Board of the Fund.
- 8.2 The President or, if he is prevented, the Vice-President shall represent the Fund in judicial and other matters.

Commentary

Article 8.2, reflects the recommendation of the Central Bank Legal Experts on the ESCB Statute and draws on Article 13.6 of the Protocol of the EIB. The latest draft of the ESCB Statute, however, reverts to the earlier wording, "The President or his nominee shall represent the ESCB externally".

Article 9 (A14) - National central banks

- 9.1 At the request of the Executive Board, the national central banks shall assist the Fund in the execution of its tasks.
- 9.2 National central banks shall continue to carry out their responsibilities under national law provided that these do not interfere with their obligations under this Statute. In particular, the Member States shall ensure that the statutes of national central banks are compatible with this Statute and this Treaty.

Commentary

This is a much less detailed and less prescriptive Article than the ESCB equivalent, in accordance with the more limited role of the EMF and the continuing responsibilities of national central banks for national monetary policies. The ESCB Statute provides inter alia (A14.2) that the Governor of a national central bank be appointed by national authorities only after consultation with the ESCB Council.

This article would not require any amendment to domestic primary legislation under the Bank of England Act 1946.

CHAPTER III - MONETARY FUNCTIONS AND OPERATIONS OF THE SYSTEM

Article 10 (A17) - Accounts with and held by the EMF

In order to carry out its tasks, the Fund may open accounts for, and hold accounts with, national central banks, other public entities, credit institutions and other market participants.

Commentary

This is based on ESCB Article 17 but specifies the capacity to open accounts not only for but with national central banks and other market participants, which would be essential for the EMF to issue and manage the HECU. This also implies that it may issue liabilities and hold claims; that could alternatively be made explicit here in order to complete the list of permitted financial operations otherwise spelt out in Article 11 below. There might be less need for the EMF to open accounts for public entities when national central banks still perform this function in their national currencies, but it might nevertheless be useful in the context of the repurchase and maintenance of value obligations.

No particular currency is specified here. The question of HECU, other Community currency and third country currency operations needs to be established in the context both of this Article and of Articles 11 and 16 below.

Article 11 (A18) - Open market and credit operations

- 11.1 In order, and to the extent necessary, to carry out its tasks, the Fund may:
- operate in the financial markets by buying and selling outright (spot and forward) or under repurchase agreement, and at its discretion, claims and marketable instruments such as Treasury bills and other securities, denominated in [hard ECUs] and other Community currencies [and in non-Community currencies, as well as precious metals];
 - conduct credit operations with credit institutions and other market participants.
- 11.2 The Fund shall establish general principles for open market and credit operations in [hard ECUs] carried out by itself or the national central banks on its behalf including the announcement of conditions under which it stands ready to enter into such transactions.
- 11.3 Open market and credit operations in [hard ECUs] carried out by the national monetary authorities on their own behalf shall be in accordance with principles agreed with the Fund.

Commentary

In Article 11.1, the question of EMF operations in non-Community currencies is currently under discussion. The status of the HECU within the ERM is covered in Treaty Article VII.

Article 11.2, closely modelled on the ESCB Statute, runs into a potential difficulty which would not exist with a single currency. It is intended to provide for the possibility that the EMF might carry out its operations through the agency of national central banks but it could be deemed to cover operations in HECU by national central banks on their own account. Article 11.3 has therefore been added to govern market operations in HECUs by national monetary authorities, given the possibility of conflict with the obligations of the EMF and the possible conflict of interest between a national central bank's domestic policy actions and its execution of EMF instructions as agent.

Article 12 (A16) - Notes and coins

The Fund shall have the exclusive right to authorise the issue of notes & coin denominated in [hard ECU] which shall have the status of legal tender in any particular Member State if the authorities in that Member State so decide.

Commentary

This gives the EMF the exclusive right to authorise the issue of HECU notes. This is the formulation adopted for the ESCB, since many Member States envisage that their national central banks would print and issue their own notes denominated in the single currency (as do the individual Federal Reserve Banks in the United States). The amount of HECUs issued thus rests with the EMF. The important question to be resolved is the distribution of the seignorage.

The ESCB Statute likewise requires ESCB approval of the volume of coins issued.

Article 13 (A20) - Other Instruments

The Governing Board may decide [unanimously] [by qualified majority] upon such other methods or instruments for the implementation of monetary policy in relation to the [hard ECU], subject to the requirement of Article II.3 of the Treaty, as it sees fit.

Commentary

Article 148 of the EEC Treaty defines a qualified majority (for the purposes of action by the Council) as one that secures the support of 54 out of a total of 76 possible votes, where the 76 votes are determined on the basis of a distribution key of the weights of the member states. In addition, except where the issue derives from a proposal from the Commission, the 54 votes must have been cast by at least eight members. The ESCB Statute does not offer any definition for this particular purpose (for which a qualified majority of unweighted votes might be thought more suitable) but does provide for a qualified majority of votes weighted according to a new key for voting on financial matters (see EMF equivalent at Article 23 below).

The reference to Treaty Article II.3, which would require the EMF to act consistently with free and competitive markets, is intended to debar direct or quantitative methods of control. In contrast to the ESCB Statute (A19), no separate provision is made in this draft for the entitlement of the EMF to impose reserve requirements. Such an entitlement is presumably subsumed in the above Article 13 but, in being thereby directly subject to Treaty Article II.3, it might therefore be held (as we would wish) that the imposition of a compulsory reserve requirement would be permissible only if such reserves carried a market rate of interest.

Article 14 (A21) - Operations with public entities

14.1 The Fund shall not grant overdrafts or any other type of credit facilities to Community institutions, governments or other public entities of Member States or purchase debt instruments directly from them.

14.2 The provisions of this Article shall not apply to publicly-owned credit institutions.

Commentary

The Article of the ESCB Statute on which this is modelled, is still the subject of debate in Basle particularly insofar as it refers to the ECB and national central banks. It seems inappropriate to include in an EMF Statute any Stage 2 restrictions on monetary financing in national currencies by national central banks.

The ESCB Article also empowers the ECB and national central banks to act as fiscal agent for Community institutions and governments.

The purpose of Article 14.2, which mirrors that in the ESCB Statute, is to enable the EMF to have dealings with state-owned commercial banks.

Article 15 (A22) - Clearing and payment systems

The Fund may provide facilities and establish provisions to ensure efficient and sound clearing and payment systems across the Community and with third countries.

Commentary

It is clear that some responsibility for HECU clearing and payment systems should reside with the EMF. As drafted, this Article should also enable the EMF to play its part in such systems for Community currencies and between the Community and third countries.

[Article 16 (A23) - Operations with third countries]

[In order, and to the extent necessary, to carry out its tasks, the EMF shall be entitled to conduct all types of banking transactions in relation to third countries and international organisations, including borrowing and lending operations.]

Commentary

This Article, which is derived from an Article in the ESCB Statute, provides the EMF with an external locus should the HECU come to acquire an international role. As this possibility is not unrelated to the question of EMF holdings of third currencies, which is still under discussion, the Article has been placed in square brackets.

The equivalent Article in the ESCB Statute also provides for the establishment of relations with central banks and international institutions and for dealing in foreign exchange and precious metals. The first of these provisions, as regards the EMF, is mirrored in Treaty Article V and is not repeated here. The second is omitted here on the grounds that market interventions in third currencies (and gold) are not envisaged as being a core function of the EMF and on the presumption that Article 10 empowers the EMF to receive funds denominated in third currencies in the event that national banks exercise their repurchase obligation against "hard" third currencies.

Article 17 (A5) - Collection of statistical information

The Member States and the Community institutions shall co-operate with the Fund in providing, or collecting, on its behalf, such statistical or other information as may be necessary to enable it to perform its functions.

Commentary

It can be argued that, if existing national responsibilities and conceptions of territoriality are to be unchanged during this stage, the EMF should acquire such information only through the agency of national central banks and not by means of powers granted to it over national economic agents (as is provided for in the ESCB text).

If the EMF is to ask for information that is not at present collected this may require subordinate legislation in the UK.

Article 18 (A24) - Other operations

In addition to operations arising from its tasks, the Fund may enter into operations that serve its administrative purposes or for its staff.

Commentary

As ESCB Statute.

Article 19 (A15) - Reporting and financial statement

- 19.1 In addition to the reporting obligations laid down in Article IX of this Treaty, the Fund shall report on its activities at regular intervals. These reports are to be published and to be made available to interested parties free of charge.
- 19.2 A financial statement of the Fund shall be published each week. Copies shall be sent to the Council and to the European Parliament.

Commentary

The equivalent Article in the ESCB Statute, which deals with Inter-Institutional Co-operation, also requires the ECB to draw up an annual report on the activities of the system and on monetary policy which it may present to the European Council, the Council of Ministers and the European Parliament. For the EMF, this provision appears in Article X.3.

CHAPTER IV - PRUDENTIAL SUPERVISION

Article 20 (A25) - Supervisory questions

- 20.1 The Fund shall be entitled to offer advice and to be consulted on the interpretation and implementation of Community legislation relating to the prudential supervision of credit and other financial institutions and financial markets insofar as such legislation may affect the management of the [hard ECU], for which the Fund has responsibility, or such other tasks as it may acquire, in accordance with Articles III and VI of this Treaty.
- 20.2 [The Fund shall be entitled to offer advice to Community bodies and national authorities on measures relating to the [hard ECU] which it considers desirable for the purpose of maintaining the stability of the banking and financial systems.]

Commentary

This Article follows the ESCB Statute formulation but restricts the EMF's locus to matters affecting the HECU. It omits the ESCB Statute references to the formulation and implementation of supervision policy and of measures to maintain the stability of the banking and financial system. If, however, all the responsibilities of the Committee of Governors are to be taken on by the EMF Governing Board, some more general role in the co-ordination of national supervisory policies should be given to the EMF.

If this is envisaged as an appropriate task for the EMF, it is for consideration whether it should be provided for in the Treaty, either explicitly or as an additional task in terms of proposed Treaty Article 3.2.

CHAPTER V - FINANCIAL PROVISIONS

Article 21 (A26) - Financial Accounts

- 21.1 The financial year of the Fund shall begin on the first day of January and end on the last day of December.
- 21.2 The annual accounts of the Fund shall be drawn up by the Executive Board in accordance with the principles established by the Governing Board. The accounts shall be approved by the Governing Board and shall thereafter be published.

Commentary

This a simplified version of the equivalent ESCB Article, omitting the requirement of a consolidated balance sheet for the System and the standardisation of accounting procedures.

Article 22 (A27) - Auditing

The accounts of the Fund shall be audited by independent external auditors recommended by the Governing Board and approved by the [Council of Ministers]. The auditors shall have full power to examine all books and accounts of the Fund and to require full information about its transactions.

Article 23 (A28) - Voting on financial matters

For the purposes of Articles 24 and 25 of this Statute decisions of the Governing Board shall be adopted by qualified majority, that is to say, the votes in the Governing Board shall be weighted according to the key attached and forming part of this Statute and a decision shall be deemed to be approved if it carries [...] votes out of the total of [...].

Commentary

It is intended that the key, which would also be used for the provision of capital and the allocation of profits and losses, should correspond to the relative size of national GNP. This principle has not yet been agreed for the ESCB Statute but is a likely outcome. Article 13 above also provides for qualified majority voting (on possible new monetary policy instruments) but does not refer to weighted votes.

Because of the important financial implications, it is envisaged that modification of the key would entail a procedure requiring a political decision. As the key forms part of the EMF Statute, it may be amended according to the procedure (unanimous decision by the Council, after consultation) laid down in EMF Treaty Article I.

Article 24 (A29) - Capital of the Fund

- 24.1 The capital of the Fund shall, upon its establishment, be [hard ECU] [x] million. The capital may be increased from time to time by such amounts as may be decided by the Governing Board.
- 24.2 The national central banks shall be the sole subscribers to and holders of the capital of the Fund. The distribution of capital shall be according to the key attached to this Statute.
- 24.3 The Governing Board shall determine [the extent to which and] the form in which capital shall be paid-up.
- 24.4 The shares of the national central banks in the subscribed capital of the Fund may not be transferred, pledged or attached other than in accordance with a decision taken by the Governing Board.
- 24.5 If the key attached to this Statute is modified in accordance with Article I of this Treaty, the national central banks shall transfer among themselves capital shares to the extent necessary to ensure that the distribution of capital shares corresponds to the revised key. The Governing Board shall determine the terms and conditions of such transfers.

Commentary

Agreement has not yet been reached in the Basle discussions as to the appropriate amount of initial capital which an ECB would need, although several Member States consider that to have sufficient credibility from the outset the amount should be large (a ball-park figure of ecu 9 billion) and fully paid up. It is possible to argue that the EMF, because of its narrower function and its evolutionary nature, should have a much smaller initial capital which could be only partly paid up. The use to which capital may be put is not specified.

Some central bank representatives believe that the form in which the ECB's capital should be paid up (see Article 24.3 above for the EMF) should not be left to a decision by the ESCB Council but should be defined in the Statute.

Article 25 (A32) - Allocation of income, losses and profits

- 25.1 The net profits of the Fund to be distributed shall be determined by the Governing Board on the basis of the balance sheet and the profit and losses account of the Fund. The Governing Board shall establish the accounting rules and procedures in this respect.
- 25.2 The Fund shall establish a General Reserve.
- 25.3 Following transfers to the General Reserve, the remaining net profits of the Fund shall be distributed to its shareholders according to the key which is attached to and forms part of this Statute.
- 25.4 In the event of a loss incurred by the Fund, the shortfall shall be offset, in order of priority:
- against the General Reserve;
 - and, if necessary, following a decision by the Governing Board, by means of transfers of assets to the Fund by the national central banks according to the key which is attached to and forms part of this Statute.

Commentary

This is a much simplified version of the ESCB equivalent since the EMF would not have such a direct involvement in the operations of national central banks and the allocation procedure could therefore be more straightforward. The approach adopted above assumes that profits and losses should be borne by national central banks in proportion to their capital subscription. It might be desirable to make separate provision also for losses attributable to the EMF's holdings of specific Community currencies and/or for the maintenance of value requirement. The implications for the redistribution of seigniorage, to the extent that the HECU is substituted for national currency in circulation, must also be considered.

CHAPTER VI - GENERAL PROVISIONS

Article 26 (A36) - Staff

- 26.1 The Governing Board, on a proposal from the Executive Board, shall lay down the Staff Regulations of officials and the conditions of employment of other servants of the Fund.
- 26.2 The Court of Justice shall have jurisdiction in any dispute between the Fund and its servants within the limits and under the conditions laid down in the Staff Regulations and the Conditions of Employment.

Commentary

This follows the ESCB Statute but does not specify the scope of the Staff Regulations.

Article 27 (A38) - Professional secrecy

Members of the Governing Board and of the Executive Board, officials and other servants of the Fund shall be required, even after their duties have ceased, not to disclose information of the kind covered by the obligation of professional secrecy.

Commentary

This Article is in line with Article 214 of the Treaty and with what is proposed for the ESCB, although it omits the reference in that Statute to specific Community secrecy legislation. It does not allow for compliance with a Court Order to declare. Drafters of the ESCB Statute suggest that the ESCB Council could be allowed to lift the prohibition in such cases, at its discretion.

Article 28 (A40) - Signatories

The Fund shall be legally committed vis-a-vis third parties either by the signature of the President or by the signatures of two members of the Executive Board or by two members of the staff of the Fund who have been duly authorised by the President to sign on behalf of the Fund.

Commentary

This follows closely the equivalent Article in the ESCB Statute, which is derived from analogous provisions in central bank statutes. It provides assurance to third parties in respect of the persons who are able to commit the ECB.