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THE EUROPEAN MONETARY SYSTEM - PRESENT SITUATION AND FUTURE PROSPECTS

by

L E O N H A R D   G L E S K E

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Introductory remarks

Three years ago, on April 8, 1978, the European Council agreed in Copenhagen that a common strategy should be worked out for greater stability of exchange rates in the EEC. The Council also hoped that this would contribute towards reversing the divergent trends in economic and social developments in the Community since the first oil price shock. This might then turn out to be a stepping stone to closer economic and monetary union.

Two years experience with the European Monetary System may have disappointed some of these hopes: since the spring of 1979, when the EMS started after some delay, the economic problems at Community level and in most member states have become larger rather than smaller. Admittedly, the difficulties are not typical of the EEC and are not limited to it. The whole world economy is confronted with considerable additional burdens and uncertainties as a result of the oil price increases of 1979 and 1980: worldwide boosts to inflation, the global risks of recession and the large external imbalances cast a dark shadow across international economic relations. They present great challenges both to our ability to adjust our economies and to the solidarity of the Western world.

+This address was delivered in Florence on May 4, 1981

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The extent of the problems involved becomes clear when it is borne in mind that in 1981 the OPEC countries will record current account surpluses of nearly the same order as last year, some 100 billion dollars according to IMF estimates. Consequently, countries that are highly dependent on oil imports must once again face up to large deficits in their current accounts, estimated at around 60 billion dollars for the OECD countries taken together, of which some 45 billion must be borne by EEC countries. Unfortunately, various factors belie the hope that oil-induced balance of payments disequilibria in the world will be reduced at a similarly rapid pace as in the period after 1973/74. This means that, for the foreseeable future, economic and monetary policy in our countries face the task of reducing the serious disequilibria in our current accounts and of seeing to it that the deficits are financed in the meantime.

I. The situation at the outset

As you know, the European Monetary System replaced the European exchange rate arrangement, the "snake", which was born in 1973 after the breakdown of the international monetary system that was centred on the dollar. At that time the EEC countries tied their currencies together in order to float joint-

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ly against the dollar. Within a few months some of the original participants left this first Community attempt at a system of fixed exchange rates, reducing it to a "mini-snake", or as some would prefer to call it, a "DMark-zone". The creation of the EMS was not merely a means to reincorporate other EEC currencies into the existing system. The pooling of reserves, the enlargement of credit facilities and other provisions of the new system, and the intention of the Heads of State and Government to see the system consolidated into a European Fund indicate that the project extends much beyond that.

As is well known, opinions differed for a long time on the means by which a monetary union should be achieved. For Germany's part, "economic" reasoning as opposed to reliance on "monetary" or exchange rate constraints has always had precedence. Under the "economic approach", economic, fiscal and monetary policies pursued with the objective of achieving a large measure of convergence in the economic development of the member states, were considered essential to the achievement of stable exchange rate relationships, with a high degree of price stability in all countries as the best promise of lasting success.

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Against that, the ideas and models submitted by others for the European Monetary System tended to emphasize a more "monetarist approach", which in this particular context implies a firm commitment to fixed exchange rates and to intervention in the exchange markets, supported by adequate credit facilities, as major instruments to achieve harmonization in other fields of economic policy, including particularly monetary policy.

The formula actually adopted comprises elements of both approaches. It can be found in the final paragraph of the Bremen communiqué on the European Monetary System, according to which the "system of closer monetary cooperation will only be successful if participating countries pursue policies conducive to greater stability at home and abroad". Thus, the European Monetary System is the child of two parents, which may be taken as a good omen for its survival.

II. Experience with the European Monetary System

The existing global economic tensions and imbalances make the EMS an ambitious undertaking. The short period of two years is hardly sufficient for a final judgment on the contribution of the European Monetary System to monetary stability in Europe and to European integration.

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At best, a preliminary judgment is possible. Two things may be said at the outset, however: More than two years of the EMS have neither confirmed the fears of those who foresaw large-scale intervention and recourse to credit facilities in an effort to defend the agreed margins of exchange rate fluctuations around bilateral central rates; nor have they revealed significant progress towards the greater convergence in economic performance and policies considered essential in the longer term if the EMS is to fulfill the expectations placed in it.

1. As regards <u>external stability</u>, i. e. exchange rate stability, a preliminary evaluation of the European Monetary System would on balance be positive. There were only the two limited exchange rate adjustments in the first year of the EMS affecting the Deutsche Mark and the Danish krone, and then the more recent devaluation of the lira. These adjustments were performed smoothly without undue disturbance to the markets. At most times, moreover, exchange rates were kept within the existing bands around the agreed bilateral central rates without too great difficulties and without too great expense in terms of intervention, and without any recourse to the ample credit facil-

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ities which are available. That this proved possible in circumstances that undoubtedly would have prompted wider fluctuations of rates against each other in response to market forces without the existence of the EMS is no mean achievement. In many ways this experience was different from what some people expected, and in fact feared, when the EMS was negotiated and decided upon. Many observers saw the risk of large-scale intervention in support of certain potentially weak currencies, or intervention designed to keep relatively strong currencies from breaking through the margins at the top. After years of strength, and continuing appreciation against other currencies, the DM was clearly seen as a currency that might constantly tend to push against the upper limit of the EMS band. Tying it firmly to other major currencies that were less prone to appreciate against third currencies, especially the U.S. dollar, was not universally regarded as advisable, since this carried with it the risk of serious strains as known from the early phase of the "snake" experiment. It was not obvious from the beginning that the conflicts to which this might give rise could be resolved easily under the formula adopted for changes of

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central rates, which called for mutual agreement by all partners. So far no major problems have in fact arisen. Intervention was sizable at times, particularly in support of currencies such as the Belgian franc. And there was also substantial intervention involving the DM, but not in order to prevent it from breaking "through the roof", but on the contrary to support it in a situation of weakness. The DM has also been used more widely than was perhaps initially envisaged (at least on the German side) for "intra-marginal intervention", which is undertaken largely in order to smooth out rate movements within the band. The prolonged weakness of the DM to which I have referred, and the need to support it at times within the EMS came at first as somewhat of a surprise. But it helps to explain the relative absence of tensions in the EMS over its first two years of existence. There are a variety of factors that account for that weakness, some of them may be only temporary, others may turn out to be of somewhat longer duration.

Foremost among these factors is the firmness which the U.S. dollar has regained relative to most other currencies. This is partly due

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to the move by the United States from the position of a deficit country through most of the seventies to a surplus country in its current payments, whereas most other industrial countries have moved sharply into current deficit in the wake of the second oil crisis (the United Kingdom being the other notable exception). But it is also due to the high level of interest rates which has prevailed over many months now in the United States as part of the anti-inflationary stance of monetary policy pursued by the Federal Reserve System.

In these circumstances of a generally stronger dollar, the DM turned out to be among the weaker currencies; this became specially visible in its position at the lower end of the EMS margin during most of last year and lasting until mid-February of this year.

Just as the surplus position on current account favoured the dollar, the exceptionally large current account deficit assumed by Germany - 28 billion DM, or 16 billion dollars in 1980 - weighed heavily on the DM. And the high interest

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rates which exerted a strong pull on funds to be placed in dollar investments contrasted with relatively low German interest rates throughout 1980. But German interest rates were not only low compared with dollar rates, they were also low compared with those in other countries in Europe. Most of the countries in the EMS continue to have much higher inflation rates than Germany, and it is not surprising that they also have correspondingly higher interest rates. For some time now these countries (including Italy as a prime example) have been pursuing restrictive monetary policies not only in order to assure that their exchange rates remain safely within the EMS band, but for domestic reasons as well. So far these restrictive policies have not led to the greater stability of domestic prices which alone will promise more stable exchange rate relationships in the longer run, but they have helped to maintain cohesion of the exchange rate pattern of the EMS in its initial phase.

The fact that the DM's weakness has helped cohesion to be maintained within the EMS is, of course, not reason enough to view this weakness with satisfaction; quite to the contrary.

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From our own German point of view this prolonged weakness of the DM, both globally and within the EMS, could only be viewed with considerable concern. And it is doubtful whether it should be viewed as positive from a European point of view. Just as the prolonged weakness of the U.S. dollar cannot be called a universal blessing, a weak DM in the EMS is not likely to be helpful when viewed in a longer-term perspective. The international roles of the dollar and of the DM - especially in its European context - are such that trade and payments of all countries will be adversely affected if the key currencies are subject to doubt and instability. I need only point to the existence of large multinational companies which will be strongly affected in their world-wide operations by the changing fate of the major trading and investment currencies. Faced with currency uncertainty they will try to safeguard their position, and this may in turn add to the disturbances to which currencies are subjected.

The weakness of the DM signalled a market judgment which was different from that of earlier years; it could not - so it turned out - be assumed to be reversed quickly

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and of its own,because it reflected a change in the underlying position of the DM,not in terms of the stability of domestic prices and costs relative to those in other countries, but in terms of the current account of the balance of payments and of some of the factors responsible for its sharp turn into deficit (including factors that are related to our dependence on imported oil and to the sharply deteriorating "structural" elements in our foreign trade and invisible transactions); and it mirrored a certain measure of scepticism concerning the ability to reverse the adverse trend within a reasonable time.

The nominal depreciation of the DM vis-à-vis the dollar, some 10 per cent during 1980 (and another 13 per cent up to mid-February 1981),was long considered both undesirable and unwarranted, mainly for three reasons:

- it was in clear contrast to the inflation differential in Germany's favour, both against the dollar, and - more importantly - against the average of our trading partners, and

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- it entailed the risk of inflationary impulses through higher import prices and the 'vicious' effects on domestic costs and prices and incomes; and

- the downward movement of the exchange rate was still thought likely to be reversed within a relatively short period of time once the 'recognition lag' of the underlying greater stability and strength of the DM elapsed.

Against that the expectation of positive gains, especially on the export side, of a substantial 'real' depreciation was given much less weight. Some improvement of the trade balance was at any rate thought likely as the cyclical and 'locomotive' effects of more rapid demand growth in Germany than elsewhere diminished, and the 'real' depreciation resulting from greater price stability - with nominal exchange rates assumed relatively unchanged - worked itself through to import and export volumes.

What this adds up to is that the German authorities did not opt for an apparant 'easy way out' of the newly emerged balance

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of payments predicament, because they simply did not see an easy way out; they still do not see an easy way out. Their actions show that they did not adopt any of the recommendations given to them, comprising devaluation of the DM within EMS, or temporary suspension of participation as a means to escape from an "exchange rate trap". Total 'benign neglect' of the newly emerged balance of payments constraint and concentration on the domestic economic constraints of high unemployment and slow growth was considered a real possibility by those who called for low interest rates while leaving the correction as well as the financing of the large current payments deficit to its own devices, or to good fortune. Some proponents of such formulae argued that the "stability bonus" of the DM could not be expected to bear fruit so long as more attractive investment opportunities were offered by other currencies bearing a relatively higher rate of interest, and possibly helped, at least momentarily, by insulation from major exchange risk under the rules of the EMS in the prevailing circumstances. Even though these views contained certain elements of truth, they could not

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be adopted as a guide to policy, for a number of reasons. One of these rests on the fact I have already alluded to, namely that the weakness of the DM within the EMS - though in good part the mirror image of the strength of the dollar - mainly reflected such factors as the exceptionally high German deficit on current account, the particularly low level of interest rates compared with other industrialised countries, and certain other non-economic factors, which called for policies that promised to deal effectively with the causes of the imbalance. In such circumstances neither intervention to support the exchange rate at a particular level was likely to be an adequate response over any length of time; nor was it felt that the balance of payments constraints could be simply ignored, and the exchange rate be left entirely to the forces of the market, as some suggested. As it turned out, monetary policy had to be shifted eventually so as to narrow the existing wide interest rate gap somewhat and to restore a sounder basis for public confidence at home and abroad in the intentions and actions of policymakers. In fact, the confidence factor in the rationale for the decisions taken on

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February 19, 1981 by the central bank may merit as much weight as the actual interest rate effects, if not more. As a result, the position of the DM against the dollar has been stabilized, and the DM has moved back to the upper end of the EMS band.

But it would be very premature to claim that all problems have been overcome; this is far from the truth. With exchange rates relatively stable within the EMS, the persistence of wide inflation differentials raises the possibility of countries with relatively stable costs and prices such as Germany importing inflation from other more inflationary partner countries with double-digit rates of inflation. During 1980 when the DM tended to be weak generally against other currencies and depreciated measurably against the dollar as well as on a trade-weighted basis, this was a threat which was not typical of the EMS and to Germany's participation in that system. It posed a more generalized problem for monetary policy which had to try to keep external impulses from higher oil prices and other import prices due to the worsening of the

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terms of trade from spreading and thus fuelling domestic inflation. In this, monetary policy was reasonably successful in 1980, though the inflation rate in fact rose somewhat faster towards the end of the year than at the start. As I have said, the risk of imported inflation through 'real' depreciation of the exchange rate was a problem extending beyond the EMS. But it may still be instructive for a moment to look at certain bilateral exchange rate relationships within the EMS, especially the example of Germany as compared with Italy. This example shows that even the room provided by the wider margins of fluctuation for the lira of ± 6 per cent in the EMS (and taking into account the realignments that have been undertaken so far) has not been large enough to offset the existing gap in inflation rates between the two countries for any length of time. In the two years from the start of the EMS up to March 20, 1981 (i. e. excluding the devaluation of the lira on March 12, 1981) the Deutsche Mark appreciated by only 7.4 % against the lira; while in the years 1979 and 1980 taken together consumer prices in Italy rose four times faster than in Germany (39 % compared to 10 %). The devaluation

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of the lira implied a further appreciation of the Deutsche Mark by only 2.2 % up to the present date.

Recent experience with the devaluation of the lira proves that the system allows for necessary adjustments of central rates in the EMS to be undertaken in good time. The mutual agreement required under the system in such cases can be attained provided there is clear evidence of the need for adjustment, as has been the case for the lira. It is understandably difficult to prepare changes in central rates a long time beforehand if they are not to cause speculation and instability. This makes it all the more important to hold constant consultations which signal the emergence of tensions at an early date. What may be less evident in some cases is the adequacy of measures in other fields to assure the lasting success of any exchange rate adjustment. Countries will always be given the benefit of the doubt; but they in turn should be fully conscious of their responsibility for the cohesion of the system to which they belong.

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2. Before turning to the broader issues of closer economic convergence within the EMS as essential to its proper functioning in the future, let me briefly touch on one other area where experience over the first two years has not been quite as expected. This is in regard to the <u>pooling of reserves</u>. ECU holdings credited to the EEC central banks by the EFMC against 20 per cent of their gold and dollar reserves serve as the instrument for settling balances that accrue as a result of intervention in EMS currencies. In less than two years the volume of ECU has more than doubled from ECU 23 billion to 49 billion; it is more than just a flaw in the system that the increase is almost exclusively due to the fact the the ECU created against gold have almost tripled in volume (from ECU 13 billion to 38.3 billion). Owing to the preliminary character of ECU creation in the initial phase of EMS, there is perhaps less danger that an overly generous supply of reserves will induce EEC countries to neglect necessary adjustment measures than might otherwise be the case. But with an autonomous creation of reserves of this

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order the EEC is setting a bad example for controlled liquidity creation, especially with respect to demands by the developing countries for increases in international liquidity. Moreover, the possibility of a reversal of the upward movement of the gold price, with the attendant danger of considerable reserve losses for some countries, cannot be dismissed entirely. At all events, the elements of instability inherent in the development of the price of gold should not be underestimated, and appropriate attention should be given to this question in the final design of the EMS.

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III. Problems of divergence in economic developments

Comparing the situation when the European Monetary System was launched early in 1979 with that of today, it cannot be overlooked that economic harmonisation in the Community has suffered a relapse. The boost to inflation in the EEC caused by the rise in oil prices has had differing effects from country to country and hence has led to greater divergences again in economic developments.

In 1981 consumer prices in the EEC will probably rise on an average by 10 1/2 %. At the beginning of the year (March) the maximum price differential between two countries with the lowest and highest inflation rates in the EEC, namely Germany and Italy, was about 14 1/2 %. In 1979 and 1980 the gap between the inflation rates of the two countries was 10.7 % and 15.7 %, respectively. It is obvious that, under a system of stable exchange rates, divergencies in price developments of such dimensions have an impact on the relative competitiveness of the countries concerned.

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Germany's greater price stability has been clearly reflected in its trade with Italy (and even more so in its trade with France). The growth rate of German exports to Italy, at 26 % in 1979 and 20 % in 1980, was almost twice as high as the increase in our exports to the industrial countries of the West taken together (14 % and 11.5 %). As a result, Italy's share in our total exports rose from 7 % in 1978 to 8.5 % in 1980: the share of our imports from Italy in total imports fell at the same time from 9.5 % to 8 %. This is only the example of our two countries as far as their foreign trade performance is concerned. However, divergencies within the EEC cover a much wider range. The current account balances of the EEC countries show great differences, ranging in 1981 from a surplus equivalent to 0.4 % of the gross national product in the United Kingdom to a deficit of some 6 % in Belgium.
Even more worrying are the figures anticipated for the net public sector borrowing requirements in the individual member countries of the EEC; in relation to the gross national product, they could range from 2 % in France to 12 % in Ireland.

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These are only some major examples of the lack of convergence of economic performance in the EEC. I said a moment ago that it was probably largely due to the distinct weakness of the Deutsche Mark last year and until the middle of February 1981 that the lack of convergence did not result in serious tensions in the EMS. Unless major progress is achieved in harmonising those factors in the individual economies that are of basic importance for exchange rates in the EMS, it is obvious that such tensions are likely to arise again once the position of the Deutsche Mark in relation to the dollar is stabilised or reversed. The monetary policy decisions adopted in Germany in mid-February were taken with a view to stabilising the DM/dollar rate as part of a more broadly based effort to deal with the imbalance which confronts us. The more stable performance of our exchange rate against the dollar since then has been paralleled by a move of the DM back towards the upper range of the EMS band, a position which appears to be somewhat more in line with the underlying stability of the DM compared with other EMS currencies, if measured in terms of price and cost trends. As recent experience has shown,

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there is no law under which the DM would be assumed to take top position within the EMS band. We have in fact always felt that the position of the DM relative to other EMS currencies would be determined in considerable degree by its position vis-à-vis the dollar, owing to its special international role as an alternative for the investment of private and official liquidity. But so long as the underlying stability of the DM especially in terms of its cost and price performance us so much greater than of other EMS currencies, a relatively strong position within the EMS band would seem to be the rule, rather than the exception, last year's experience notwithstanding.

There is in fact much leeway to be made up in the direction of greater convergence of economic developments and economic policies in the widest sense. For countries with specially high rates of inflation it is imperative that they continue with their restrictive policies; there is full agreement on that score among member countries. Depending on the individual situation, every single member country must decide where to put the main stress of its measures. There can be

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little doubt, however, that budgetary deficits in the range of 10 % of the gross national product or more are in urgent need of correction. Experience shows that public sector deficits of whatever size will not buy more employment and growth, but that they will fuel inflation and hence undermine the foundations on which sound economic and financial policies can be built.

Other areas where there is need for more convergent attitudes relate to wage and income determination as a major element in the trend of costs and prices in the various countries. It is increasingly realized that indexation, especially its more formalized varieties, has developed into a very powerful mechanism fuelling inflation. It may well be that in countries with hyper-inflation, where money has lost its function as a standard of value entirely, indexation is inescapable and may indeed serve to restore a measure of control over the inflationary process, if properly applied. We have not reached the disastrous stage of hyper-inflation and all our currencies in the EMS continue to perform their various functions. In these circumstances indexation tends to be a mechanism that serves to

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perpetuate the inflationary process rather than control it. The monetary authorities have a special stake as their instruments of monetary control are blunted by indexation; but the public at large should also be made to realize that indexation constitutes an illusion rather than an effective assurance against the erosion of real income.

IV. The prospects of the European Monetary System with respect to European integration

Let me briefly turn to the prospects for European integration and the role of the EMS. The timetable originally envisaged by the European Council for the transition of the EMS to its final stage by March 1981 could not be adhered to. At present the legal basis, as well as the economic convergence necessary for a decision of such importance, are still lacking. At any rate, major political decisions will have to be taken for such a transition to become possible. As is well known, the final system will entail changes from the rules that apply during the transitional phase in three major respects, namely

- the establishment of a European Monetary Fund (EMF)

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- the unrestricted use of the ECU as a reserve asset and means of settlement, and

- the consolidation of the existing credit mechanisms in a single fund.

In our view the transition to the final stage constitutes a "qualitative jump" in the process of integration in the European Community because it implies the transfer of an important aspect of the sovereignty of member countries to a Community institution, namely the European Monetary Fund. Before this transfer can actually take place greater clarity must exist as to the factors and rules according to which decisions are to be made at Community level. Moreover, there must be greater assurance that exchange rate stability between the EEC currencies will be supported by a greater degree of convergence in economic developments and economic policy. Last but not least, the legal basis for transferring powers to the Community at national and Community level must be established. I believe we all agree that such far-reaching decisions cannot simply be based on provisional regulations.

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Of course, the question can also be raised whether the transition to the final stage should be undertaken before all the member countries of the Community have fully assumed their rights and duties under the present system and have gathered experience with them. In concrete terms, this poses the question of the participation of the United Kingdom and Greece as well as the special conditions conceded to Italy. Let me make a few brief comments on these points.

In principle, the timing of a decision to take part in the existing EMS with full rights and obligations should be left to each individual country. This is especially true so long as the EMS has not taken on its final form. There can be good reasons - and in this context I am thinking particularly of Greece, which must first be gradually integrated into the common market - for refraining from accepting full membership in the EMS for a transitional period. But there may be good reasons for other countries as well to first aim for greater economic stability before they assume all the obligations within the system.

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But the transition of the EMS to the institutional stage would be difficult to imagine if certain member countries, including possibly such large member states as the United Kingdom and Italy, were to stay outside or participated only to a limited degree. Some of the rules envisaged for the final stage, e. g. with respect to credits, would probably not leave much room for individual Community countries enjoying a special status. In this field, prolonged hesitation to participate could actually paralyse the will to pursue policies that are conducive to being a full partner in the System.

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V. The European Monetary System in its final form

Major questions connected with the final design of the European Monetary System still need to be clarified. Past discussions in the Monetary Committee and in the Committee of Central Bank Governors have however clearly illustrated the nature and complexity of the problems involved. These are, in particular, the following:

- The European Monetary Fund (EMD) and its main characteristics

With the transfer of ownership of monetary reserves and their administration, with the creation of ECUs and the granting of short-term credits to central banks, the EMF would be given functions typical of a central bank. For these reasons - and especially with respect to the possible transfer of powers in the future in the field of monetary and exchange rate policy - the EMF should have the character of a central bank. In view of the differences in the way responsibility in this field is regulated in each member state, the Funds will not be able to assume a form that reflects the

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interventions will not be transferred to the Fund. In so far as the medium-term support mechanism is transferred to the EMF, this can only mean the assumption of financing and administration by the Fund; decisions on granting medium-term credits and the conditions attached to them should remain the prerogative of the Council of Ministers.

- Role of the ECU

The ECU will only have a chance of becoming a fully-fledged reserve asset and instrument for settling balances in the future if it can be made at least as attractive as other reserve assets, in particular the dollar, as regards its usability, interest rate and maintenance of value; only then will the EEC central banks probably be prepared to hold ECUs in their reserves. In order to be able to fulfil at any time a request by EEC central banks for conversion, the EMF must be given the right to freely use the reserves transferred to it and, as necessary, must even have the possibility of taking up credit. The most promising way to further develop the ECU is no

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national setup in all the Community countries. Instead, it will be important for the Fund to be assigned the task of "safeguarding the value of the currency" and for it to be given sufficient autonomy to fulfil this task. In addition, it would be committed to supporting the general stance of the Community's economic policy.

- Parliamentary legislative procedures

Far-reaching institutional rules have to be made in connection with the creation of the EMF, such as regulating its relationship with the organs of the Community as well as with national governments and central banks. These questions must be decided on the political plane by national parliaments and at Community level.

- Consolidation of the credit mechanisms

The European Council explicity mentions only the short and medium-term credit facilities. For practical reasons and because intervention policy will remain in the foreseeable future in the hands of the national central banks, the very short-term financing of

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doubt to harden its internal value;
since it consists of a basket of member currencies, monetary stability in all member state will therefore decide the fate of the ECU in the final analysis.

- <u>Common exchange rate policy</u>

A "pooling" of national exchange rate policies within the European Monetary System is just as unlikely for the foreseeable future as a common policy towards third currencies. Although this does not exclude close coordination of monetary policy vis-à-vis third countries, the Bundesbank is, on the basis of its experience, against rules for a dollar policy that could endanger its room for manoeuvre as regards a stability-oriented monetary policy. A joint dollar policy will only be possible when economic policies and economic developments are convergent to a greater degree, with the result that the national currencies within the EEC are considered to be practically of equal value in the judgement of third parties.

The institutional design of the EMS in its final stage, as I have just outlined it, presupposes the political willingness of

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the member states to renounce national sovereignty in favour of the Community. There is no sign of this being the case at present. Moreover, with the creation of the EMS an advance step was taken in the monetary field which must be supported by closer economic coordination and more effective harmonisation in economic developments. From a legal point of view, also in the opinion of our EEC partners, the EMS has reached a demarcation line which can only be crossed by amending the EEC treaty or by means of a corresponding international agreement.

Whether, in the course of its gradual extension, the EMS will become the forerunner of a European monetary union obviously does not depend on its technical design but on the policies it is to serve. If the Community succeeds in finding a satisfactory answer to the numerous questions that are sill open, then it would also make an effective contribution to a viable international monetary system.

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