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COMPLEMENTARY NOTE ON THE PROPOSAL FOR THE CREATION OF A EUROPEAN RESERVE FUND (E.R.F.)

The general philosophy of the proposal for the quick creation of a European Reserve Fund is inspired by two observations.

The creation by 1992 of a single European market for capital transactions and financial services is an irreversible process in which European countries have engaged and which requires central banks of countries participating in the EMS to improve monetary policy coordination at both internal and external levels.

The sizeable fluctuations within the international monetary system have led central banks to rely more heavily on intervention in the foreign exchange markets on a coordinated basis. However, such a policy necessarily has a direct influence on the implementation of domestic monetary policies in these countries. It is therefore necessary and urgent that central banks create means for analysing such issues on a permanent and common basis. It is not only a matter of strengthening the impact of their operations, but also of maintaining the efficiency of their monetary management both at domestic and European levels.

I - THE SPIRIT OF THE PROPOSAL FOR THE CREATION OF A EUROPEAN RESERVE FUND

The proposal is inspired by four leading ideas.

1 - Initiating a training ground process

The creation of a European Reserve Fund aims at promoting common reflection and approach with regard to monetary issues in a framework which would allow permanent information exchanges, regular comparison between analyses and deeper knowledge of short term economic developments and policies implemented in individual countries.

The target is to initiate a training ground process allowing individual member countries not only to improve the coordination of their monetary policies but also the management of the increasingly growing interaction between exchange rate and monetary policies.

2 - <u>Strengthening the impact of intervention policies in the foreign exchange markets as designed within the Group of Seven</u>

The aim of intervention that the European Reserve Fund would be led to make will be to underline, as far as possible and considered useful, central banks' will to act on a coordinated basis within the EC framework.

In its implementation, intervention by the European Reserve Fund would, in a first phase, strengthen the impact of operations agreed in common by central banks, without increasing their volume. Such intervention would thus have no additional effect, either directly or indirectly, on internal monetary policies of member states. As a matter of fact, it could be agreed that the E.R.F.'s intervention should only take place after unanimous agreement has been reached between central banks of member countries.

3 - <u>Creating a permanent think-tank on monetary analysis</u>

In order to continue to play its strategic role in the construction of Europe, monetary policy must rely on a common think-tank on monetary developments. In this area, the current framework of cooperation may be further improved, not as a substitute for national decision-taking, but in order to harmonize, in a first phase, concepts, analyses as well as instruments available for monetary policy.

Obviously, decisions are not to be reached at the level of the experts in charge of such a surveillance. Policy choices in this area will still be made sovereignly by individual countries, but, prior and parallel to these decisions, analyses and recommendations will be made in common. This phase is therefore of a major significance in order to promote a consistent analysis of monetary developments and to reassert to the markets the highest priority given to the common objective of price stability.

4 - <u>Increasing the role of the Committee of Governors</u>

With such views, the role of the Committee of Governors will have to be strengthened. However, in order to ensure that Governors do not limit themselves to exchange views, but can open discussions which might result in recommendations, regular advices of their experts will have to be made available to them, not only with regard specifically to monetary issues, but also, as already arranged each month for the foreign exchange market, with regard to any matter influencing monetary policy implementation, including short term economic developments.

It is thus in this spirit that my proposal calls for the creation of an institutional embryo, i.e. the European Reserve Fund, which has the advantage of gathering within a permanent framework monetary and foreign exchange policy experts of participating central banks in order to make available to the Governors regular and global assessments of monetary developments. This is one major aspect of the proposal : it is indeed necessary, from the initial phase of the process, to create between central banks a common thinking framework which goes beyond the continuation or even a deepening of cooperation between central banks.

II - COMPLEMENTARY INFORMATION ON E.R.F.'S OPERATING PROCEDURES

1 - Reserve contributions

As a counterpart to their final contributions, central banks would receive shares. The question arises whether contributions of individual central banks should be periodically readjusted.

There are two possible approaches :

- on the one hand, it could be considered, as is the case with the EMCF, to maintain a fixed relation in percentage between the amount of reserves held by the shareholding central banks and their contributions to the E.R.F. Such a solution which calls in question the final character of initial contributions turns out rather complex ;
- on the other hand, it could be decided not to establish an automatic link between the volume of E.R.F.'s assets and the amount of reserves held by its shareholders. The final character of the contributions would be confirmed by the decision to renounce any periodical readjustment ; as it is, the relatively low level set in the proposal for shareholders' initial contributions should prevent any central bank from putting forward a decrease in its reserves in order to reduce its contribution to the E.R.F. and to strengthen its own means of intervention.

2 - Allocating E.R.F.'s operating income

The E.R.F.'s operating income will result from the investment of exchange reserves. The E.R.F.'s income statement would take the operating costs of the Fund into account and the net income -possibly after allowing for provisions- would be allocated among shareholders in proportion to their contributions.

3 - Decision-taking for intervention in the foreign exchange markets

As mentioned above, in a first phase, intervention decisions would be agreed in common by members, thus preventing any particular operation from hindering the domestic policy followed by any given country.

In a second phase -which should be agreed on unanimously- the shareholding central banks could decide to hand over to the E.R.F. the power to undertake certain operations on its own initiative, in compliance with the guidelines set by the Governors on the Board of Directors.

4 - A non-automatic process

In spite of what some people may have thought, the present proposal involves no automatic speeding up toward the final objective of monetary integration.

As underlined in the note, the first phase which has been suggested is clearly defined and the process may be interrupted if the decision to proceed with the second phase is not reached unanimously.