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THE EUROPEAN RATE MECHANISM: IT CONTINUES TO FUNCTION, BUT . . . .

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It has been forcefully argued that the United States is now one of three major global trading blocks, Japan and Europe being the other two; and that in many respects it is the weakest of the three.[1] In support of these propositions, facts are adduced to demonstrate that in many industries and settings the United States has lost its position as a leader or initiator and is now in a reactive rather than a pro-active role.[2]

The recession from which the United States is just emerging, and in which much of the rest of the industrialized world is still mired, differs from many others preceding it. In part this is so here because some of the classic nostrums appear ineffective. For some time, interest rates in the United States have been at their lowest level in decades.[3] Yet the low interest rates do not appear to be producing the usual effect of spurring capital investment and economic growth as rapidly as might be expected.

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1. For an in-depth discussion of this issue, see LESTER C. THUROW, HEAD TO HEAD (1992).

2. *Id.* at 153-201.

3. *See* Rick Wartzman, *Bentsen Expects Interest Rates to Hold Steady*, WALL ST. J., Dec. 20, 1993, at A2; David Wessel, *Federal Reserve's Policy-making Panel Kept Steady Stance on Interest Rates*, WALL ST. J., Dec. 27, 1993, at A2.

One reason that they have not produced the usual rate of growth has been the existence of substantially higher rates in Europe.[4] Given the normal tendency of capital to seek higher rates of return, some funds otherwise available for investment here have sought higher rates of return in Europe. Thus, to some extent at least, the growth of the United States' economy is controlled by events in Europe and its monetary policy. The roiling currency markets of September 1992 are additional evidence of this phenomenon.[5] Perhaps one good effect of that currency crisis was the attention it focused on the interdependence of the global financial system. The little understood, in the United States, the European Monetary System ("EMS") and the European Rate Mechanism ("ERM") are now matters of great interest because of the effect they have on the value of the dollar and the United States economy. This article discusses the working of the ERM as part of the EMS and describes their relationship to European Community law and institutions.

I. HISTORICAL OVERVIEW

It is widely understood that the ERM and EMS are creatures of the European Community. But it may be somewhat more surprising that EMS, as the structure within which the ERM operates, and the ERM itself have been functioning substantially in the same form since 1979. Various component mechanisms and institutions have been in place for considerably longer.

The current movement within the EC toward monetary union, with a single currency and central bank, embodied in the Treaty on European Union (the Maastricht Treaty)[6] has been widely discussed.[7] That Treaty's provi-

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4. Fed Discount Rate — 3%; U.K. base rate — 6%; German Lombard rate — 9%; French rate — 7.25%. *Money Rates*, WALL ST. J., Mar. 29, 1993, at C17.

5. *See generally Mayhem*, ECONOMIST, Sept. 19, 1992, at 15; *Meltdown*, ECONOMIST, Sept. 19, 1992, at 69; Martin Wolf, *From Delusion to Devaluation*, FIN. TIMES, Sept. 30, 1992, at 20.

6. Treaty on European Union, signed at Maastricht on 7 February 1992, 1992 O.J. (C 191) 1, (C 224) 1 [hereinafter Treaty on European Union or TEU]. The Treaty on European Union became effective Nov. 1, 1993. *See* David Garder, *Treaty Celebration Gives Way to Sober Talks*, FIN. TIMES, Oct. 30-31, 1993, at 3. The Treaty on European Union substantially amends portions of the Treaty of Rome. TREATY ESTABLISHING THE EUROPEAN ECONOMIC COMMUNITY [EEC TREATY], Mar. 25, 1957, 298 U.N.T.S. 11.

In this article references to Treaty of Rome provisions amended by the TEU are to the EC TREATY (as amended 1993); references to Treaty of Rome provisions as they were in effect prior to the TEU are to the EEC TREATY; and references to TEU provisions not amending the Treaty of Rome are to the TEU.

The Treaty on European Union's provisions on monetary union are contained in TEU, art. G, which contains all of the amendments to the Treaty of Rome. Specifically, these provisions are articles 102a-109m of the EC TREATY (as amended 1993).

7. *See, e.g.*, Editorial Comments, *Post-Maastricht (Monetary Union)*, 29 COMMON MKT. L. REV. 199 (1992); Hugo J. Hahn, *The European Central Bank: Key to European Monetary Union or Target?*, 28 COMMON MKT. L. REV. 783 (1991); Nancy L. Kessler, *Banking on Europe: 1992 and EMU*, 60 FORD. L. REV. 395 (1992); Rutsel S.J. Martha, *The Fund Agreement and the Surrender of Monetary Sovereignty to the European Community*, 30 COMMON MKT. L. REV. 749 (1993); Wayne Sandholtz, *Choosing Union: Monetary Politics and Maastricht*, 47 INT'L ORG. 1 (1993); Christopher A. Whytock, *Eurofed: Toward a European System of Central Banks and a European Central Bank*, 23 LAW & POL'Y INT'L BUS. 469

sions for monetary union, both the single currency and the central bank, are the capstones of an integrated monetary system. But the Community's drive for monetary union did not begin with the run up to the Maastricht Treaty. The building blocks on which these significant capstone provisions rest have been in place for many years. The Community has been working toward centralization and unification of the monetary system for almost thirty years.[8]

The monetary union provisions of the Treaty on European Union are largely adapted from the Delors Report of 1989.[9] They envision, as recommended in the Delors Report, a monetary union to be accomplished in stages.[10] One purpose of the ERM is to force member states' currencies into a

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(1992). *See generally* Trevor C. Hartley, *Constitutional and Institutional Aspects of the Maastricht Agreement*, 42 INT'L & COMP. L.Q. 213 (1993).

8. *See, e.g.*, Council Decision 64/301 of 8 May 1964 on Cooperation Between Member States in the Field of International Monetary Relations, 1963-1964 O.J. SPEC. ED. 143 [hereinafter Decision on International Monetary Relations Cooperation]; Council Decision 64/300 of 8 May 1964 on Cooperation Between the Central Banks of the Member States of the European Economic Community, 1963-1964 O.J. SPEC. ED. 141 [hereinafter Decision on Central Banks Cooperation]; Commission Memorandum to Council on the Co-ordination of Economic Policies and Monetary Cooperation within the Community, 2 BULL. E.C. No. 3 (Supp. 1969). See also the numerous documents regarding monetary cooperation contained in MONETARY COMMITTEE OF THE EUROPEAN COMMUNITY, COMPENDIUM OF COMMUNITY MONETARY TEXTS (1989)[hereinafter COMPENDIUM].

9. *See* COMMITTEE FOR THE STUDY OF ECONOMIC AND MONETARY UNION, REPORT ON ECONOMIC AND MONETARY UNION IN THE EUROPEAN COMMUNITY (1989) [hereinafter DELORS REPORT]. At its meeting in June 1988, the European Council reaffirmed its objective of progressive realization of economic and monetary union. 21 BULL. E.C. No. 6 (1988), at 165. It created a special committee to study the issue and propose concrete measures that would help the Council accomplish its goal. *Id.* The committee was comprised of the governors of the central banks of the Member States, three prominent economic and banking experts, and two members of the Commission, including Jacques Delors, the president of the Commission. Delors chaired the committee.

The committee issued the Delors Report in April 1989. *See* 22 BULL. E.C. No. 4 (1989), at 8. The report reviewed the past developments toward monetary union and restated the advantages of such a union. It then set forth a blueprint and timetable for accomplishing the union. *See generally* COMMISSION OF THE EUROPEAN COMMUNITIES, ECONOMIC AND MONETARY UNION (1990); Andrew Gamble, *EMU and European Capital Markets: Toward a Unified Financial Market*, 28 COMMON MKT. L. REV. 319 (1991); Kessler, *supra* note 7, at 418-28; Jean-Victor Louis, *A Monetary Union for Tomorrow*, 26 COMMON MKT. L. REV. 301 (1989); Sandholtz, *supra* note 7.

The European Council, despite strong objections from the United Kingdom and Denmark, determined that monetary union, largely on the terms of the Delors Report, would become a reality. At its December 1989 meeting, the European Council reiterated the main theme of the Delors Report and convened an intergovernmental conference to prepare amendments to the Treaty of Rome which would accomplish economic and monetary union. 22 BULL. E.C. No. 12 (1989), at 11. In October 1990, despite opposition from Britain, the European Council determined that a new institution responsible for Community-wide monetary policy should be created by the Treaty of Rome and that, in the final stage of monetary union, there would be a single currency. 23 BULL. E.C. No. 10 (1990), at 18. These measures had been advocated since at least 1970. *See infra* notes 43 and 47 and accompanying text. Negotiation of these provisions, however, proved extremely difficult. *See* Alison Smith & Quentin Peel, *Major Rejects Draft Union Treaty*, FIN. TIMES, Nov. 11, 1991, at 1. Agreement was finally reached in December 1991 at the European Council meeting in Maastricht. 24 BULL. E.C. No. 12 (1991), at 7. The final text of the Treaty on European Union was signed at Maastricht on February 7, 1992. 25 BULL. E.C. No. 1-2 (1992), at 11. *See generally* TEU, *supra* note 6.

10. DELORS REPORT, *supra* note 9, at 34-40. At its June 1989 meeting the European Council decided

very close and stable relationship with one another, thereby facilitating the transition to a single currency. The measures comprising the ERM are working apart from the Treaty on European Union, and are subsumed within it. The changes in the ERM agreed upon in August 1993,[11] while not altering the ERM structure, most likely will mean that the time tables for achieving monetary union envisioned in the Treaty on European Union are, at best, optimistic.[12]

Monetary union was not one of the explicit goals of the Treaty of Rome in its original form. There are, nevertheless, several articles within it dealing with monetary policy, in particular with the Member States' conjunctural policies and balance of payments practices.[13]

Article 103 provided that the Member States' conjunctural policies, that is their policies regarding short term business cycles and measures intended to stabilize economic trends, were matters of common concern within the Community. Each state was obliged by Article 103 to consult with the others and with the Commission on measures it wished to take in this area.[14] In addition, the Council was authorized to decide upon appropriate Community-wide measures and to issue directives in this area.[15] A more substantive obligation was contained in Article 104, by which the Member States were obliged "to pursue the economic policy needed to ensure the equilibrium of its overall balance of payments and to maintain confidence in its currency. . . ."[16] This obligation is carried over into Article 105, by which Member States were obliged to coordinate their economic policies to cause their various administrative departments and their central banks to cooperate to

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that the first stage would begin on July 1, 1990. This is the date that Council Directive 88/361 fixes for the abolition of all restrictions on the movement of capital. Council Directive 88/361 of June 24, 1988 for the Implementation of Article 67 of the Treaty, 1988 O.J. (L 78) 5 [hereinafter Directive on Article 67 Implementation]; 22 BULL. E.C. No. 6 (1989), at 11. As provided in the Treaty, the second stage should begin January 1, 1994. EC TREATY art. 109(e)(1) (as amended 1993). The third stage should begin no later than January 1, 1999. *Id.* art. 109(j)(4) (as amended 1993). Yet it could begin as early as January 1, 1997. *Id.* art. 109(e)(3) (as amended 1993). *But see infra* note 12 and accompanying text.

11. *See infra* notes 129, 136-37 and accompanying text. *See generally* Alan Riding, *Softer Franc Could Help to Bolster the Economy*, N.Y. TIMES, Aug. 2, 1993, at D8; Craig R. Whitney, *Europeans Agree to Let Currencies Fluctuate Widely*, N.Y. TIMES, Aug. 2, 1993, at A1, D8.

12. *See infra* note 176. *See generally* Lionel Barber, *Ministers Veto Early Return to Old ERM*, FIN. TIMES, Oct. 11, 1993, at 1; Quentin Peel, *Kohl Warns of Two-Year Delay for Monetary Union*, FIN. TIMES, Aug. 10, 1993, at 1. The August 1993 modifications have not changed the ERM structure or obligations but have significantly modified the "set points."

13. These provisions, articles 103-109, were not significantly amended by the Single European Act, but have been replaced by articles 102a-109 of the Treaty on European Union. EEC TREATY arts. 103-09 (as amended 1987); EC TREATY arts. 102a-109 (as amended 1993).

14. EEC TREATY art. 103(1); *see* Case 9/73, Schluter v. Hauptzollamt Lorrach, 1973 E.C.R. 1135.

15. EEC TREATY art. 103(2). *See generally* 3 HANS SMIT & PETER E. HERZOG, THE LAW OF THE EUROPEAN ECONOMIC COMMUNITY 3-651 to 3-675 (1993). For a list of Council and Commission implementing measures, see *id.* at 3-651 to -657.

16. EEC TREATY art. 104. *See generally* 3 SMIT & HERZOG, *supra* note 15, at 3-679.

attain the objective set forth in Article 104.[17] Article 107(1), similarly to Article 103, made Member States' policies regarding exchange rates a matter of common concern. Member States were authorized by Article 107(2) to take countermeasures in the event another Member State altered its exchange rates in a manner which is inconsistent with the objective of Article 104 and which seriously distorts competition.[18]

Articles 108 and 109 dealt with balance of payment problems and both provided the possibility of mutual assistance among Member States to ease these crises and allowed Member States to take limited protective measures.[19]

Despite these modest substantive obligations, the Treaty of Rome dealt with monetary cooperation matters institutionally, or structurally, in a more substantial way. A Monetary Committee was created by Article 105(2), to be comprised of two persons from each Member State and two from the Commission. The two national members were to be representatives of the respective Member State's treasury or finance ministry and its central bank.[20] As established, this Committee has advisory status. It was charged with reviewing the monetary and financial situation and the general payment system in the Member States and the Community and was to report on these matters to the Council and the Commission.[21] In addition, it was to be consulted on certain matters regarding the free movement of capital[22] and balance of payments.[23]

By the mid-1960s, the Council had assigned the Monetary Committee a more active, although still only consultative, role in international monetary matters. Consultations were to take place within the Monetary Committee regarding important decisions or positions taken by Member States in international monetary matters, including those pertaining to the general working of the international monetary system.[24] Moreover, the Member States were only to take such decisions or positions after consultation with the Monetary Committee.[25] However, the exception to this requirement is stated so broad-

17. EEC TREATY art. 105(1). *See generally* 3 SMIT & HERZOG, *supra* note 15, at 3-607 to -697.

18. EEC TREATY art. 107; *see also id.* art. 103.

19. *Id.* arts. 108-09. *See generally* JEAN-VICTOR LOUIS, FROM EMS TO MONETARY UNION (1990); 3 SMIT & HERZOG, *supra* note 15, at 3-694.12(13) to -.12(98).

20. EEC TREATY art. 105(2). *See generally* RICHARD W. EDWARDS JR., INTERNATIONAL MONETARY COLLABORATION 83 (1985); LOUIS, *supra* note 19, at 15. Under the Treaty on European Union, the European Monetary Institute will replace the Monetary Committee at the beginning of the second stage, January 1, 1994. EC TREATY art. 109(f) (as amended 1993). Its function and procedures are set forth in protocol 4 to the Treaty on European Union. TEU, *supra* note 6, protocol 4.

21. EEC TREATY art. 105(2).

22. *Id.* arts. 69, 71, 73.

23. *Id.* arts. 107-109.

24. Decision on International Monetary Relations Cooperation, *supra* note 8, art. 2; *see* Directive on Article 67 Implementation, *supra* note 10; *see also* 3 SMIT & HERZOG, *supra* note 15, at 2-737 to -745.

25. Decision on International Monetary Relations Cooperation, *supra* note 8, art. 2.

ly that such consultations were not encouraged.[26]

Over the years, the Monetary Committee's role evolved to be a supervisory and coordinating one in all matters involving monetary affairs, both in preparation for Council discussions on finance and monetary matters and otherwise. Also, it was assigned a specific role in the fixing of central exchange rates against the European Currency Unit (the "ECU").[27]

At the same time the Monetary Committee's mandate was expanded, the Council created a separate entity, the Committee of Governors of the Central Banks of the Member States.[28] The Commission has no member on this committee, but is invited to send a representative to attend its meetings. As stated in the Council Decision establishing this committee, its ambit of authority was twofold: (i) to hold consultations regarding general principles and policies of the central banks, in particular, regarding credit and the money and foreign exchange markets; and (ii) to exchange information regarding the most important measures falling within the competence of the banks and to examine those measures.[29] It also had a role in the working of the ERM.[30]

The need for stable currency relationships within the Community — if not a single currency — in order that the overall objectives of the Community might be attained is obvious. The previously mentioned articles in the Treaty of Rome demonstrate that the signatories were mindful of these needs; but clearly the Treaty left the field largely inchoate.

The initial goal of the EC was economic interpretation not monetary integration. This is so in part because during the EC's early history, the international monetary system was relatively stable, as were exchange rates. This stable external order explains in part the paucity of Treaty of Rome provisions regarding monetary integration. Rates were fixed under the Bretton Woods Agreement's regulation of exchange rates.[31]

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26. The exception to the requirement for consultation is "when circumstances and in particular the time limits . . . require otherwise." *Id.*

27. *See infra* notes 108-12 and accompanying text. Its activities are reported periodically in the BULLETIN OF THE EUROPEAN COMMUNITIES [BULL. E.C.].

28. Decision on Central Banks Cooperation, *supra* note 8, art. 1.

29. *Id.* art. 3.

30. *See infra* notes 108-12 and accompanying text. In 1990, during the first stage of monetary union, the role of this Committee was expanded. Council Decision 90/142 of Mar. 12, 1990 Amending Council Decision 64/300/EEC on Cooperation Between the Central Banks of the Member States of the European Economic Community, 1990 O.J. (L 78) 25. Among the changes were requirements that national authorities: (1) consult the Committee before making major monetary policy decisions; (2) express opinions to Member State governments and the Council on policies that might affect the internal and external monetary situation in the Community; and (3) prepare annual reports on their monetary and financial conditions. *Id.* art. 3. The Delors Report had recommended that these changes to the Committee's competence be implemented during the first stage of monetary union. DELORS REPORT, *supra* note 9, at 35.

31. JOSEPH A. GOLD, EXCHANGE RATES IN INTERNATIONAL LAW AND ORGANIZATIONS 137 (1988); *see* Articles of Agreement of the International Monetary Fund, July 22, 1944, 2 U.N.T.S. 39, as amended May 31, 1969, 20 U.S.T.I.A.S. 2775, and Apr. 30, 1976, 29 U.S.T.I.A.S. 2204.

Clearly an unstable monetary system with widely fluctuating exchange rates hinders the goals of economic integration and barrier-free trade. Widely fluctuating rates themselves are barriers to trade. Moreover, widely divergent fiscal and monetary policies among the Member States — while perhaps necessary because of differing economic conditions — contribute to fluctuating exchange rates and currency instability. Measures taken in one Member State to combat serious inflation, or the threat of inflation — such as high interest rates when low rates prevail in another sluggish economy — create a serious cross current which adversely affects governments and private interests in the respective countries. The need for coordinated economic and monetary plans among the members is obvious. Some measures taken by the European Community in this regard pre-date the Single European Act[32] and measures taken pursuant to its 1992 program to assure the free movement of capital.[33]

The Treaty of Rome provisions referred to, while noting that matters such as conjunctural policy and balance of payments were matters of common concern, obligated the Member States to do very little. Consultations were to take place before significant measures were taken, but the Member States were free to act independently and in their own interests.[34] In certain areas, Member States were authorized to take individual countermeasures.[35] Moreover, there were few Community based initiatives in this general area.

Although in the early years the Community established the structure for dealing with monetary cooperation matters, the Community's activity in the field was modest. The monetary policy, including currency values and bal-

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32. *See, e.g.*, Council Decision 120/74 of 8 February 1974 on the Attainment of a High Degree of Convergence of the Economic Policies of the Member States of the European Community, 1974 O.J. (L 63) 1; Council Decision 141/71 of 22 March 1971 on the Strengthening of Coordination of Short-Term Economic Policies of the Member States of the European Economic Communities, 1971 O.J. SPEC. ED. 174; Council Decision 69/227 of 17 July 1969 on Coordination of the Short-Term Economic Policies Cycle Policy of the Member States, 1969 O.J. SPEC. ED. 350; Decision on International Monetary Relations Cooperation, *supra* note 8. *See generally* 3 SMIT & HERZOG, *supra* note 15, at 3-679 to -685.

33. After the Single European Act and the 1992 Program, the need for an effective Community-based enforcement of a stable monetary regimen became even more imperative. As part of the Single Market Program, all restrictions on capital movement were to be eliminated. Capital could move freely from a low interest rate member to a high interest rate country, thereby potentially exacerbating the exchange rate disparity. For example, article 1 of the Directive on Article 67 Implementation requires Member States to abolish all restrictions on free movement of capital from one state to another. Directive on Article 67 Implementation, *supra* note 10, art. 1. The Commission, after consulting the Monetary Committee and the Committee of Governors of the Central Banks, may authorize a Member State to take certain protective measures in the event that short-term capital movements of exceptional size pose a severe strain on the foreign exchange markets and disturb the conduct of a Member State's monetary and exchange rate policies. *Id.* art. 3.1. If a Member State takes such measures unilaterally because of the urgency of the situation, it must report these facts to the Commission. The Commission would then determine whether the Member State may maintain such measures. *Id.* art. 3.2.

34. *See, e.g.*, Decision on International Monetary Relations Cooperation, *supra* note 8.

35. *See, e.g.*, EEC TREATY arts. 107(2), 108, 109.

ance of payments matters, remained a matter of Member State concern. While Article 104 of the Treaty appeared to at least obligate Member States to have regard for the effects of their policies on other states, the policies remained the prerogative of the Member States.[36] Further although Article 107 provided that exchange rates are a matter of common concern, it did not require the coordination of monetary policy or concerted action. Each Member State remained free to establish its own rates of exchange.[37] Despite this status of the "law," the Community had begun to encourage joint action for monetary cooperation — and indeed union — early on.

The EC Council articulated very early the need for coordinate or joint action in the area of monetary policy. The preamble to the Council's 1964 decision to create the Committee of the Governors of the Central Banks[38] states that economic union must "include the implementation of economic and monetary policies that help insure stable exchange parities between the currencies of the Member States."[39] The need for convergent monetary policies became more critical in the late 1960s and early 1970s with the unravelling of the Bretton Woods system.[40] In the late 1960's, Chancellor Brandt suggested an EC program to be phased in over several years, beginning with harmonized short term monetary policies and proceeding to a monetary union of fixed exchange rates.[41]

By the end of the 1960s sufficient agreement on this matter was reached for the Commission to authorize a major study by national and EC officials of the prospects for monetary union.[42] The resulting Werner Report[43] of October 1970 was a significant guiding force in the construction of the EMS as it presently exists. It was quite explicit in its recommendations regarding monetary cooperation and union and timetables for their implementation. It suggested monetary union was realizable by 1980.[44] Upon its conclusion,

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36. Michael H. Ryan, *The Treaty of Rome and Monetary Policy in the European Community*, 10 OTTAWA L. REV. 535, 538 (1978).

37. Joined Cases 9 & 11/71, Compagnie d'Approvisionnement de Transport et de Credit S.A. v. Commission, 1972 E.C.R. 391, 400; Case 9/73, Schluter v. Hauptzollamt Lorrach, 1973 E.C.R. 1135, 1161; Case 10/73, Rewe-Zentral v. Hauptzollamt Kehl, 1973 E.C.R. 1175, 1191; *see* Ryan, *supra* note 36, at 541-43.

38. Decision on International Monetary Relations Cooperation, *supra* note 8, pmbl.

39. *Id.* The origin of the EMS can be traced to this Council decision. GOLD, *supra* note 31, at 141.

40. DANIEL GROS & NIELS THYGESEN, EUROPEAN MONETARY INTEGRATION 12 (1992); LOUIS, *supra* note 19, at 12; Ryan, *supra* note 36, at 545.

41. GROS & THYGESEN, *supra* note 40, at 12; *see also* David Cobham, *The European Monetary System: An Economic Perspective*, 1988 Y.B. EUR. L. 87, 88, 93.

42. Integral Text of the Final Communique of the Conference of the Heads of State or Government on Dec. 2, 1969 at the Hague, 3 BULL. E.C. No. 11 (Supp. 1970), at 31.

43. Report to the Council and the Commission on the Realization by Stages of Economic and Monetary Union in Community, 3 BULL. E.C. No. 11 (Supp. 1970), at 3 [hereinafter Werner Report]. This report was named after Pierre Werner, the Finance Minister of Luxembourg, who chaired the study.

44. *Id.* at 26-29. The report did not set forth a precise timetable. It suggested a variety of substantive and institutional measures which could be taken in two phases. The first phase was a period of three

this union was to include elimination of exchange rate fluctuations, irrevocable fixing of parity rates and free movement of capital.[45] The Report stressed the need for Community based action, in contrast to the individual Member State action, for the coordination of economic and monetary policies,[46] and urged the creation of various institutions to administer the monetary union.[47]

Less than a year later, the Council and representatives of the Member States adopted a Resolution on the Attainment of Economic and Monetary Union,[48] which gave effect to various suggestions and recommendations in the Werner Report. Through this Resolution, the Member States expressed their will to establish a monetary union during the decade beginning in 1971,[49] and they presented various short term measures which were to be taken to accomplish this goal. Among other things, the Resolution provided that during a three year period (ending in December 1976) the Council should set forth provisions for strengthening the coordination of short term economic policies; setting forth the outlines for a Community-wide economic policy, the harmonization of the instruments of economic policies among Member States and the synchronization of national budgetary procedures.[50] The Council agreed that additional emphasis should be placed on obligatory prior consultation by the Monetary Committee and the Committee of Governors of the Central Banks with the aim of strengthening the coordination of monetary policy.[51] The central banks were invited to coordinate their policies.[52] Also, they were invited on an experimental basis to hold exchange rate fluctuations within narrower margins than those in force for the U.S. dollar.[53]

The Council noted that, depending on the results of harmonizations of economic policies and other circumstances, measures might be taken to es-

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years, beginning January 1971. *Id.* at 27. The second phase would begin January 1974 and could result in economic and monetary union by the end of the decade. *Id.* at 26; *see* Cobham, *supra* note 41, at 88.

45. Werner Report, *supra* note 43, at 26.

46. *Id.* at 10, 26.

47. *Id.* at 12-13, 17-18, 25.

48. Resolution of the Council and of the Representatives of the Governments of the Member States of 22 March 1971, on the Attainment by Stages of Economic and Monetary Union, 1971 J. O. (C 28) 1 [hereinafter Resolution on Attainment of Economic & Monetary Union]; COMPENDIUM, *supra* note 8, at 33. This Resolution is not a binding legal commitment. The Commission had requested this in a Memorandum and Proposal to the Council on the Establishment by Stages of Economic and Monetary Union, 1970 J.O. (C 140) 20. The Commission had made similar proposals as early as 1964. Ryan, *supra* note 36, at 544 n.33.

49. Resolution on Attainment of Economic & Monetary Union, *supra* note 48, art. I; *see* Werner Report, *supra* note 43, at 27-28.

50. Resolution on Attainment of Economic & Monetary Union, *supra* note 48, art. III, § 1.

51. *Id.* art. III, § 5(i).

52. *Id.* art. III, § 5(ii); *see* Werner Report, *supra* note 43, at 11.

53. Resolution on Attainment of Economic & Monetary Union, *supra* note 48, art. III, § 7; *see* Werner Report, *supra* note 43, at 28; *infra* note 61 and accompanying text.

tablish a *de jure* system of intervention in currencies and a reduction in the margin of fluctuation between currencies.[54] The Council committed itself to adopt before the end of the first stage (December 1976) measures which would ultimately lead to full economic and monetary union.[55]

That the Council intended to move the members from an obligation to consult, which may have been nothing more than a notification after the fact,[56] to something more binding is evident from a Decision issued that same day. In Council Decisions of 22 March 1971,[57] the Member States became obligated to coordinate their monetary and credit policies.[58] The central banks, within their own authority, were invited to coordinate their policies in monetary and credit matters, and to establish guidelines to be followed regarding liquidity, terms for credit and interest rates.[59]

The Werner Report outlined in considerable detail the advantages of narrowing bilateral exchange rate fluctuations.[60] The Community took significant steps in this regard in late 1971 and early 1972, when the members agreed to limit exchange rate fluctuations.[61]

Finally in 1973, the Council established the European Monetary Coopera-

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54. Resolution on Attainment of Economic & Monetary Union, *supra* note 48, art. III, § 7; *see* Werner Report, *supra* note 43, at 28.

55. Resolution on Attainment of Economic & Monetary Union, *supra* note 48, art. IV.

56. LOUIS, *supra* note 19, at 14.

57. Council Decision 142/71 of 22 March 1971 on Strengthening of Cooperation between the Central Banks of the Member States of the European Economic Community, 1971 O.J. SPEC. Ed. 176.

58. *Id.* art. 1.

59. *Id.* art. 2.

60. Werner Report, *supra* note 43, at 6-7.

61. Agreement of Central Banks 24 April 1972 on Narrowing of Exchange Rate Margins, COMPENDIUM, *supra* note 8, at 60 [hereinafter Basle Agreement]; *see* GROS & THYGESEN, *supra* note 40, at 16-17; Ryan, *supra* note 36, at 545-48. Under the Bretton Woods Agreement, currencies were assigned a par value in terms of the gold value of the U.S. dollar; they were allowed to fluctuate only minimally from that value. *See generally* EDWARDS, *supra* note 20, 491-568. In December 1971 the Smithsonian Agreement was reached, under which a realignment of exchange rates was accomplished through the devaluation of the U.S. dollar in relation to gold, and a readjustment in the values of other currencies in view of this devaluation. Communique of the Ministerial Meeting of the Group of Ten, Dec. 18, 1971, *reprinted in* 23 INT'L FIN. NEWS SURV. 417, 417 (1972). These readjustments were an attempt to redress the U.S. balance of payment crisis. Under the agreement, rates were allowed to fluctuate as much as 9% from the par value. The effort did not succeed and within several months many countries, including the U.S., simply allowed their currencies to float. Press Communique of the EEC Council of Finance Ministers, Mar. 12, 1973, IMF SURV., Mar. 26, 1973, at 88; Press Communique of the Ministerial Meeting of the Group of Ten and the European Economic Community, Mar. 16, 1973, *id.*; EDWARDS, *supra* note 20, at 497-500.

The Basle Agreement was the European Community Member States' response to the Smithsonian Agreement. A conclusion of the Werner Report was that narrower exchange rate margins, leading to stabler exchange rate relationships, were preferable as a means of achieving economic and monetary integration. In the Basle Agreement, many of the EC members attempted to implement this notion. They agreed that their currencies could fluctuate in relation to one another by only 4.5% (/-2.25%), half that allowed by the Smithsonian Agreement. This arrangement was referred to as the "snake in the dollar tunnel." After March 1972, when currencies began to float, this agreement stood alone, without the walls of the "tunnel." *See* Cobham, *supra* note 41, at 89; Richard W. Edwards, *The European Exchange Rate Arrangements Called the 'Snake,'* 10 TOL. L. REV. 47, 48-54 (1978).

tion Fund ("EMCF"),[62] as recommended in the Werner Report.[63] This entity was established to take the actions necessary for a proper functioning of the Community exchange system, the multilateralization of currency positions resulting for central bank intervention and administration of short term financing.[64] The EMCF is administered by a board of governors who are in fact the same individuals who are the members of the Central Bank Committee.[65] Later this entity was given the authority to issue ECU's and to play a pivotal role in the EMS.[66]

Monetary union cannot take place unless the economic and monetary policies and positions of the Member States are in a state of equilibrium; they must have arrived at about the same place at the same time. Article 103 of the Treaty of Rome set the stage for a process to achieve such co-incidence by providing that the Member States treat their conjectural polices — that is, their short term business cycle policies and measures intended to stabilize economic trends — as matters of common concern.[67]

The European Community, building on Article 103 and the Resolution on Attainment of Economic and Monetary Union,[68] moved in earnest from the individual action allowed under the Treaty of Rome to coordinated and Community based action in 1974. On 18 February 1974, the Council issued the Convergence Decision.[69] This Decision set up a structure for frequent meetings regarding economic and monetary matters, including three Council meetings a year to review the economic conditions within the Community.[70] In Article 1, the Council took for itself the right to issue guidelines in the form of directives, decisions and recommendations which the Member States "are to follow in order to achieve harmonious economic development."[71] The Convergence Decision also directed the Member States to initiate prior consultations before changing the parity, central rate or intervention points of

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62. Council Regulation 907/73 of 3 April 1973 Establishing a European Monetary Fund, 1973 O.J. (L 89) 2 [hereinafter Regulation Establishing European Monetary Fund].

63. Werner Report, *supra* note 43, at 23, 29.

64. *Id. See generally* EDWARDS, *supra* note 20, at 85.

65. Regulation Establishing European Monetary Fund, *supra* note 62; Statute of the European Monetary Cooperation Fund, art. 1, 1973 O.J. (L 89) 4.

66. *See infra* notes 86, 190-95 and accompanying text.

67. EEC TREATY art. 103.

68. Resolution on Attainment of Economic & Monetary Union, *supra* note 48.

69. Council Decision 120/74 of 18 February 1974 on the Attainment of a High Degree of Convergence of the Economic Policies of the Member States of the European Economic Community, 1974 O.J. (L 63) 16 [hereinafter Decision on Convergence of Economic Policies], as amended by Council Decision 787/75 of 18 December 1975, 1975 O.J. (L 330) 52, and Council Decision 136/79 of 6 February 1979, 1979 O.J. (L 35) 8; *see* Werner Report, *supra* note 43, at 27.

70. Decision on Convergence of Economic Policies, *supra* note 69, art. 1.

71. *Id.* Although somewhat vaguely worded, this sentence appears to impose on Member States an obligation to follow the guidelines. *See* Rene Smits, *Some Aspects of the Monetary Law of the European Community, in* 2 LEG. ISSUES OF EUR. INTEGRATION 39, 64 (1983).

its currency.[72]

In a companion Directive,[73] the Member States were obligated to implement short and medium term economic polices in accordance with the Council's guidelines, and to refer to them when articulating major economic decisions.[74] The Commission was given authority to make recommendations to any Member State whose economic, monetary or budgetary policies departed from the guidelines issued by the Council, or entailed economic risks for the Community.[75]

This institutional structure existed until 1978 when the EMS, as it is known today, became effective. The Single European Act,[76] ("SEA") which amended the Treaty of Rome in 1986, really did not change the 1978 structure of EMS. In fact it confirmed that structure. The Treaty of Rome provisions previously discussed, Articles 103, 104, 105 and 107, were not amended by that Act. But, in the Preamble to the SEA, the signatories acknowledged that as early as 1972 the heads of state or government approved the objective of the Community as being both economic and monetary union.[77] The Preamble also acknowledges the constitutive documents of EMS[78] and notes that steps have been taken to implement the system of monetary cooperation.[79] The SEA added a new article, Article 102(a), to the Treaty of Rome,[80] which reaffirmed the Member States' obligations under the existing system of EMS.[81] Article 102(a) noted that convergence of economic and

72. Decision on Convergence of Economic Policies, *supra* note 69, art. 7.

73. Council Decision 121/74 of 5 March 1974 on the Stability, Growth and Full Employment in the Community, 1974 O.J. (L 63) 19 [hereinafter Decision on Employment in Community].

74. *Id.*

75. *Id.* art. 11. As part of the first stage of monetary union outlined in the DELORS REPORT, *supra* note 9, both Council Decision on Convergence of Economic Policies, *supra* note 69, and Council Decision on Employment in Community, *supra* note 73, were repealed and replaced by Council Decision 141/90. Council Decision 141/90 of March 12, 1990 on the Attainment of Progressive Convergence of Economic Policies and Performance During Stage One of Economic and Monetary Union, 1990 O.J. (L 78) 23. This decision emphasized that achievement of the goals of the Single European Act would require more effective policy coordination because the Single European Act will increase financial integration, and that progress toward monetary union would require a high degree of convergence of economic performance between Member States through close coordination of economic policies. *Id.* at pmbl. The Council determined that it would undertake a multifaceted surveillance of economic and monetary matters. *Id.* art. 3; *see* text accompanying *supra* note 33. This more comprehensive approach was recommended in the Delors Report. DELORS REPORT, *supra* note 9, at 34.

76. EEC TREATY (as amended 1987); *see* George A. Bermann, *The Single European Act: A New Constitution for the Community?*, 27 COLUM. J. TRANSNAT'L L. 529 (1989).

77. EEC TREATY pmbl. (as amended 1987). The preamble to the Treaty of Rome and the objectives set forth in article 2 do not mention monetary union. EEC TREATY art. 2, pmbl.

78. *See infra* notes 84-87 and accompanying text.

79. EEC TREATY pmbl. (as amended 1987).

80. *Id.* art. 102(a)(as amended 1987).

81. *Id. See generally* 3 SMIT & HERZOG, *supra* note 15, at 3-603 to -640.49. For a discussion of the evolution of the monetary provisions of the Single European Act, see Jean-Victor Louis, *'Monetary Capacity' in the Single European Act*, 25 COMMON MKT. L. REV. 9 (1988).

monetary policy is necessary for the further development of the Community. In order to achieve this convergence, Member States were obliged by Article 102(a) to cooperate in accordance with Article 104; and in so doing they should take into account their experiences within EMS and the development of the ECU.[82] The reference in this article to both the EMS and the ECU was an acknowledgment in the Treaty itself of EMS, its structure and operating documents, which prior to this had been acknowledged only in secondary legislation and in quasi-Community documents.[83]

II. PRESENT SYSTEM IN OPERATION

EMS as currently structured is set forth in a series of documents agreed to in 1978. They are: (i) Resolution of the European Council of 5 December 1978 (hereinafter the "Brussels Resolution");[84] (ii) several very specific Council Decisions[85] and regulations;[86] and (iii) an agreement among the central banks.[87] As structured in 1978, EMS was intended to require closer monetary cooperation among the Member States, which in turn would lead to monetary stability within the Community.[88]

As envisioned in the Brussels Resolution, EMS has several purposes: (i) to provide a means of attaining a degree of monetary stability through stabilization of exchange rates within very narrow bands; (ii) to support closer monetary cooperation; and (iii) to foster economic and monetary union.[89]

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82. EEC TREATY art. 102(a).

83. This amendment to the Treaty of Rome to some extent made irrelevant a previous legal uncertainty as to the status of the EMS and the ERM within Community law. The Treaty on European Union, however, in a sense reintroduces this uncertainty. *See infra* notes 137-51 and accompanying text.

84. Resolution of the European Council on the Establishment of the European Monetary System (EMS) and Related Matters, *reprinted in* COMPENDIUM, *supra* note 8, at 45 [hereinafter Brussels Resolution]; *see* 11 BULL E.C. No. 9 (1978), at 24.

85. Council Decision 1041/78 of 21 December 1978 Amending Council Decision 143/71 Setting Up Machinery for Medium-Term Financial Assistance, 1978 O.J. (L 379) 3 [hereinafter Decision Amending Medium-Term Financial Assistance].

86. Council Regulation, 3180/78 of 18 December 1978 Changing the Value of the Unit of Account Used by the European Monetary Cooperation Fund, 1978 O.J. (L 379) 1 [hereinafter Regulation Changing Value of EMF Unit] (creating the ECU); Council Regulation 3181/78 of 18 December 1978 Relating to the European Monetary System, 1978 O.J. (L 379) 2 [hereinafter Regulation Relating to European Monetary System] (expanding the role of the EMCF to receive monetary reserves and to issue ECUs in exchange for the monetary reserves).

87. Agreement Between the Central Banks of the Member States of the European Community Laying Down Operating Procedures for the European Monetary System, 13 March 1970, *reprinted in* COMPENDIUM, *supra* note 8, at 50 [hereinafter Central Bank Agreement]. This agreement supersedes the earlier Basle Agreement. Central Bank Agreement, *supra*, art. 22.1; Basle Agreement, *supra* note 61. This Central Bank Agreement is often referred to as the Basle Agreement, the name of the earlier agreement which it superseded. In addition, there are decisions of the Board of Governors of the EMCF that parallel several provisions in the Central Bank Agreement. *See* Jean-Jacques Rey, *The European Monetary System*, 17 COMMON MKT. L. REV. 7 (1980).

88. Annex to the Conclusions of the Presidency of the European Council, *reprinted in* COMPENDIUM, *supra* note 8, at 43; Brussels Resolution, *supra* note 84, art. A1, § 1.

89. Ralph J. Mehnert, *The European Currency Unit — the ECU — Currency for the United States of*

The stabilization of rates within narrow bands is to be accomplished through the ERM. These stable rates in turn would facilitate attainment of the other objective, monetary union.

The Brussels Resolution establishes the EMS structure. As an agreement among the heads of state and governments of the Member States sitting as the European Council, the Resolution has no clear status within the hierarchy of Community law;[90] but it is a political commitment of the highest order. While some of its provisions are implemented by Community legislation and a variety of the constitutive documents of EMS, other parts of EMS — indeed the very core of the ERM — remain outside Community legislation.

The EMS and ERM function through the medium of the European Currency Unit (the ECU), a then and as yet artificial currency unit.[91] Over time the ECU has become the currency for all internal community purposes; the budget is expressed in ECU's[92] and fines for violation of EC rules, for example the competition rules, are stated in ECU's. The ECU is increasingly used in private transactions as well.[93]

The ECU is a "basket" currency unit. As created in 1978, the ECU was comprised of a specified amount of the currencies of each of the Member States, and it was assigned the same value as its predecessor, the European Unit of Account.[94] The aggregate value of the EUA also was equal to the value of one special drawing right as set by the IMF. That special drawing right in turn had a value equal to the dollar value of one ounce of gold. Thus the ECU as originally defined had a value relative to the dollar and to an external unit, the SDR.[95]

As originally composed in 1978, the amount of each Member State's currency included in the ECU was a negotiated decision, one intended to reflect the relative strength of the Member States' economies, based on gross domestic product and participation in Community external trade. However, the decision also included some subjective factors as well.[96] It was not in-

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Europe, 23 GEO. WASH. J. INT'L L. & ECON. 349, 361 (1989).

90. *See infra* note 137.

91. Regulation Changing Value of EMF Unit, *supra* note 86. *See generally* ECU: THE CURRENCY OF EUROPE (Christopher Johnson ed., 1991); CHRIS SUNT, LEGAL ASPECTS OF THE ECU (1990); J.A. Usher, *The Legal Regulation of the European Currency Unit*, 37 INT'L & COMP. L.Q. 249, 256 (1988).

92. Financial Regulation 1176/80 of 16 December 1980 Amending the Financial Regulation of December 21, 1977 as Regards the Use of the ECU in the General Budget of the European Communities, 1980 O.J. (L 345) 23.

93. *See* SUNT, *supra* note 91; Jean-Victor Louis & Etienne de Lhoneux, *The Development of the Use of the ECU: Legal Aspects*, 28 COMMON MKT. L. REV. 335 (1991).

94. Brussels Resolution, *supra* note 84, art. A2, § 1; Regulation Changing Value of EMF Unit, *supra* note 86; Communication on the Calculation of the Equivalents of the ECU and the European Unit of Account, 1979 O.J. (C 69) 4.

95. GROS & THYGESEN, *supra* note 40, at 204; SUNT, *supra* note 91, at 4; Usher, *supra* note 91, at 257.

96. GROS & THYGESEN, *supra* note 40, at 207; SUNT, *supra* note 91, at 5.

tended that this original composition be fixed forever. The composition of the ECU — that is, the amount of each Member State's currency in the ECU — was to be reviewed, and possibly altered, every five years.[97] Review could also be requested by any Member State if the value of any of that Member State's currencies changed by 25% or more.[98] Since 1978 there have been two revisions of the composition of the ECU; one in 1984, when the Greek drachma was added,[99] and one in 1989, when the Portuguese escudo and the Spanish peseta were added.[100] The next regular revision would have been in 1994. However, with the entry of the Treaty on European Union into force, the composition of the ECU has been frozen at the 1989 recomposition.[101]

The ECU consists of stated portions of each Member State's currencies.[102] It thus has no intrinsic value of its own. Nor does it directly have any value in relation to the Member States' currencies. A value can be ascribed to the ECU only by reference to an external item such as gold or perhaps another currency. The external item which the Community has adopted for use in establishing the value of the ECU is the U.S. dollar.[103]

The value of the ECU is simply the arithmetic sum of the U.S. dollar value of the fixed portions of national currencies.[104] This results, of course,

97. Brussels Resolution, *supra* note 84, art. A2, § 3.

98. *Id.*

99. Council Regulation 2626/84 of 15 September 1984 Amending Article 1 of Council Regulation 3180/78 Changing the Value of the Unit of Account Used by the European Monetary Cooperation Fund, 1984 O.J. (L 247) 1 [hereinafter 1984 Regulation Amending Value of EMF Unit].

100. Council Regulation 1971/89 of 19 June 1989 Amending Article 1 of Regulation 3180/78 Amending the Value of the Unit of Account Used by the European Monetary Cooperation Fund, 1989 O.J. (L 189) 1 [hereinafter 1989 Regulation Amending Value of EMF Unit].

101. COOPERS & LYBRAND, EC COMMENTARIES: ECONOMIC AND MONETARY UNION (1993), *available in* LEXIS, Nexis Library, EURSCP File.

102. After the 1989 recomposition, the ECU consists of the following amounts of national currencies: .6242 German marks; .08784 British pounds; 1.332 French francs; 151.8 Italian lira; .2198 Dutch guilders; 3.43 Belgian francs; .13 Luxembourg francs; .1976 Danish krones; .0085 Irish pounds; 1.44 Greek drachmas; 6.885 Spanish pesetas; and 1.393 Portuguese escudos. GROS & THYGESEN, *supra* note 40, at 207; ECU: THE CURRENCY OF EUROPE, *supra* note 91, at 16; Mehnert, *supra* note 89, at 376.

As originally composed in 1979, the ECU consisted of the following amounts of national currencies: .828 German marks; .0885 British pounds; 1.15 French francs; 109 Italian lira; .286 Dutch guilders; 3.66 Belgian francs; .14 Luxembourg francs; .217 Danish krones; and .00759 Irish pounds. Regulation Changing Value of EMF Unit, *supra* note 86, art. 1.

103. Communication on the Calculation of the Equivalents of the ECU and the European Unit of Account, *supra* note 94.

104. The method used is simply to multiply the portion of each national currency comprising the ECU by its dollar value and then to add these results. *See* Communication on the Calculation of the Equivalents of the ECU and the European Unit of Account, *supra* note 94, at 5. This is the method the Commission uses: most business days the central bank of each Member State identifies an accepted exchange rate between its currency and the dollar as of 2:30 p.m. Brussels time. Each central bank communicates this rate to the Banque National de Belgique, which in turn communicates all of the exchange rates to the Commission. The Commission then computes the value of the ECU, expressed in dollars and in the currency of each Member State. *Id.* at 4; *see* EDWARDS, *supra* note 20, at 317 n.8. These values are pub-

in the value of the ECU expressed in U.S. dollars. The value of the ECU on a given day in any Member State's currency can be determined by dividing the ECU's dollar value on that day (as determined in the manner described) by the Member State's currency exchange rate vis-à-vis the dollar.[105] The ECU's value thus floats daily as the Member States' currencies change in relation to the U.S. dollar. However, since the ECU is a basket comprised of twelve currencies, it ought to be considerably more stable than any one of the composite currencies. As the dollar appreciates against one currency, it may depreciate against another. This fact illustrates an advantage of denominating contract or other obligations in ECU's rather than directly in dollars or other member currencies. There will most likely be less fluctuation in the value of the basket ECU in relation to another currency than there would be in the value of other currencies.[106]

It is also possible to determine the relative weight of each currency in the ECU, that is, the percentage each currency represents in the aggregate value of the ECU. A currency's weight is that currency's fixed portion in the ECU divided by the aggregate value of the ECU expressed in that currency (determined in the manner described in the preceding paragraph).[107] Again the relative weight or percentage of a currency in the aggregate value of the ECU will fluctuate depending on the changes in that currency's value in relation to the dollar. A depreciation of the currency in relation to the dollar will decrease its weight and an appreciation against the dollar will increase its weight. The weight will of course also change upon recomposition of the basket. The Brussels Resolution requires the periodic re-examination of the

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lished in the Official Journal and are carried in the foreign exchange listings in major newspapers. *See, e.g.*, 1993 O.J. (C 314) 2; *World Stock Markets*, FIN. TIMES, Dec. 31, 1993, at 24; *Exchange Rates*, WALL ST. J., Dec. 31, 1993, at 24. The aggregate value of the ECU is thus partly determined by each Member State. The Commission does not determine the exchange rate between the national currencies and the dollar. Rather, it accepts the exchange rates provided by the central banks.

105. *See* Mehnert, *supra* note 89, at 370. For example, if the value of the ECU were $1.11690 (its value on Jan. 5, 1994), then the value of the ECU in marks is $1.11690 divided by the dollar value of one mark ($.5752), or 1.9417 marks. *Exchange Rates*, WALL ST. J., Jan. 6, 1994, at C11. The Commission likewise performs these computations daily. It computes and publishes the value of an ECU in each Member State's currency as well as the currencies of other major European countries and industrialized nations, including the United States, Japan, Canada, and Australia. *See supra* text accompanying note 104.

106. For example, if a U.S. corporation agreed to purchase equipment in the U.K. 18 months hence for £2 million, it bears the risk that the dollar-to-pound exchange rate will become less favorable to the dollar. If the rate at the date of the contract were £1 = $1.60, the £2 million would cost $3.2 million; if the exchange rate moves in favor of the pound to £1 = $1.85, that equipment would cost $3.7 million. The contract price could be stated in ECUs, using the dollar value on the contract date. Payment 18 months hence could be at the then-prevailing dollar-to-ECU rate. It may even be possible to provide that payment be made in ECUs. *See* SUNT, *supra* note 91, at 71-86, 115-17. Bonds and other debt instruments can be denominated and paid in ECUs. *See* ECU: THE CURRENCY OF EUROPE, *supra* note 91, at 52-111.

107. *See* Mehnert, *supra* note 89, at 371. Using the figures in *supra* note 105, the weight of the mark on January 5, 1994, would be 32.14%, the mark portion of the ECU as of the 1989 recomposition (.6242 marks) divided by the mark value of the ECU (1.9417). *See supra* text accompanying note 102.

"weights" of the currencies in the basket, not the portions.[108] Obviously it is much easier to negotiate the appropriate participation of each currency in terms of "weights" or percentages rather than portions. In its original composition the ECU was defined in terms of portions of national currencies, not weights.[109] In the two recompositions, in 1984 and 1989, the composition of the ECU was set in terms of weights as required by the Brussels Resolution, not portions; and the Council's action stating these recompositions were by regulations assigning weights on a date specified.[110] The portions of each currency in the ECU on the dates specified in those regulations were derived by the Commission, working backwards from the weights.[111] Once determined, however, those portions are fixed.[112] The weights of the currencies in the ECU would continue to change as their values of the currencies fluctuate against the dollar.

The exchange rate stability so essential to accomplishing the monetary, and indeed the economic, union — as stated in the Treaty of Rome, as amended by the Single European Act[113] and the Treaty on European Union[114] — is effected through the ERM. The structure and the processes of the ERM are set forth in the Brussels Resolution and are restated in somewhat amplified terms in the Central Bank Agreement. Participation in this system is voluntary, however. Neither the Brussels Resolution nor the Central Bank Agreement state explicitly whether participation is mandatory or optional. Participation is clearly optional, however.[115] At its most expansive

108. Brussels Resolution, *supra* note 84, art. A2, § 3.

109. Regulation Changing Value of EMF Unit, *supra* note 86.

110. 1984 Regulation Amending Value of EMF Unit, *supra* note 99; 1989 Regulation Amending Value of EMF Unit, *supra* note 100. In the two recompositions, the relative percentages or "weights" of the currencies have changed to include additional currencies and to alter the percentages of the others as a result of the renegotiation of their weights according to the criteria stated. *See* text accompanying note 97.

In the original composition, the percentages of the currencies were as follows: German mark — 32.98%; British pound — 13.34%; French franc — 19.8%; Italian lira — 9.5%; Dutch guilder — 10.51%; Belgian and Luxembourg franc — 9.63%; Danish krone — 3.03%; and Irish pound — 1.15%. EDWARDS, *supra* note 20, at 319 n.15.

As set forth in the 1989 recomposition, weights of Member States' currencies were as follows: German mark — 30.1%; British pound — 13.0%; French franc — 19.0%; Italian lira — 10.15%; Dutch guilder — 9.4%; Belgian franc — 7.6%; Luxembourg franc .3%; Danish krone — 2.45%; Irish pound — 1.1%; Greek drachma — .08%; Spanish peseta — 5.3%; and Portuguese escudo — .8%. 1989 Regulation Amending Value of EMF Unit, *supra* note 100, art. 1.

111. When the weights or percentages are agreed upon, the portions of the currencies can be determined, if the value of each currency against an external commodity, the dollar, is known.

112. It is thus still true that the ECU is comprised of fixed portions of Member State currencies. Although the negotiated recomposition is done by weights, the portions are derived from the weights. Once derived, the portions remain fixed.

113. EEC TREATY art. 102a (as amended 1987).

114. EC TREATY art. 2 (as amended 1993).

115. The Brussels Resolution notes that a Member State not participating in the ERM at the outset can do so later. Brussels Resolution, *supra* note 84, art. A3, § 1. The Central Bank Agreement is to the same effect, and the obligations under this Agreement are on "participating banks." Central Bank Agreement,

period, eleven of the twelve EC members, all but Greece, participated.[116]

The ERM is a system to enforce exchange rate stability, and it operates through the medium of the ECU. The Brussels Resolution assigns the ECU several roles in this process. First, it is the denominator (numerarie) for the ERM, and it is the basis of the divergence indicator.[117] The ERM operates not through the previously described floating value ECU, however. The Brussels Resolution describes a slightly different ECU for purposes of the ERM: A central rate against the ECU itself is assigned for each participating currency expressed in that currency.[118] The means by which this central, fixed rate is established and can be adjusted are variously stated. The Brussels Resolution provides that adjustments to the central rate are subject to agreement by a common procedure comprising all participating Member States and the Commission.[119] The adjustments are thus a matter of agreement among the participants. The Central Bank Agreement is a bit more explicit in indicating how these central rates are to be determined. It states that each participating central bank notify the Secretariat of the Committee of Governors of the Central Banks of a central rate for its currency in terms of the ECU. The Secretariat will provide this information to the other central banks and to the Commission.[120] Presumably, the rate each member unilaterally communicates is the rate agreed upon through the process set forth in the Brussels Resolution.[121] This central rate is fixed and is expressed as a stated amount of participating currency as being the value of one ECU.[122] The central rates are fixed until there is an agreed upon realignment. Such realignments have occurred much more frequently than recomposition of the

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supra note 87, at pmbl. *see, e.g., id.* art. 1.

116. The United Kingdom and Italy withdrew in September 1992. 25 BULL. E.C. No. 9 (1992), at 12-13; *see* Philip Stephens et al., *Sterling Is Suspended Within ERM*, FIN. TIMES, Sept. 17, 1992, at 1. Non-EC countries can effectively participate in the ERM and do so in anticipation of membership in the Community. For example, Norway and Sweden have done so.

117. Brussels Resolution, *supra* note 84, art. A2, § 2(a), (b). The denominator or numerarie means simply that the process is carried out through the ECU. The divergence indicator is described *infra* note 132 and accompanying text.

118. Brussels Resolution, *supra* note 84, art. A3, § 1; Central Bank Agreement, *supra* note 87, art. 1.7. As stated in the Brussels Resolution, each currency will have an "ECU-related central rate." Brussels Resolution, *supra* note 84, art. A3, § 1. To facilitate the later entry of these currencies into the ERM, a central rate also is assigned to non-participating currencies.

119. Brussels Resolution, *supra* note 84, art. A3, § 2.

120. Central Bank Agreement, *supra* note 87, art. 1.

121. In the communication issued regarding a realignment of central rates, reference was made to the process required by the Brussels Resolution. The Monetary Committee issued the communication and noted that "the ministers and central bank governors of the Member States of the European Community have decided by mutual agreement following a common procedure involving the Commission after consultation with the Monetary Committee to fix new central rates in the EMS." 26 BULL. E.C. No. 1 (1993), at 19; *see also* 25 BULL. E.C. No. 9 (1992), at 12.

122. For example, in the most recent realignment the ECU is said to have the following central rates in terms of national currencies: one ECU equals 1.95294 German marks or 6.64988 French francs. 26 BULL. E.C. No. 1 (1993), at 19.

ECU.[123]

Important as they are, the ECU central rates have a very limited function in the ERM. They are simply the medium through which a series or grid of bilateral currency conversion rates are determined.[124] The grid is a listing of the value of one currency in relation to each other currency computed through the medium of the ECU central rates. For example, if the agreed central rates were that one central rate-ECU equaled 2 german marks, 6 french francs or 1200 italian lira, a value of marks expressed in francs or lira could be derived. One german mark would equal 3 french francs, and 600 italian lira.[125] Since the ECU central rates are fixed, the bilateral grid rates are likewise fixed until there is a realignment of the central rates. Moreover, since the central rates are fixed and do not represent market rates, the bilateral grid rates likewise are not market rates.

The core of the ERM is the agreement by the participating countries in the Brussels Resolution that their currencies will fluctuate only within specified margins of the various bilateral grid rates. In sum, the ERM is simply a commitment by participating Member States to assure that the free market value of their currencies will remain within the permitted bands around each of the fixed bilateral grid rates.[126] Until August 1993, these margins were /-2.25%, or in the case of the British pound, Spanish peseta, and Portuguese escudo, 6%.[127] On August 2, 1993, the finance ministers and governors of

123. Brussels Resolution, *supra* note 84, art. A3, § 2. Since the inception of the EMS in 1978, there have been only two recompositions of the value of the ECU (1984 and 1989). By way of contrast, as of December 1993, there have been 17 realignments of central rates as provided in this article of the Brussels Resolution. The most recent realignment occurred in May 1993. 26 BULL. E.C. No. 1 (1993), at 19.

124. Brussels Resolution, *supra* note 84, art. A3, § 1.

125. The Commission published a complete set of the bilateral rates, the value of each currency in relation to each other currency in conjunction with the August 2, 1993, announcement of changes in the ERM, and also in conjunction with the 1987 realignment of the rates when Spain joined the ERM. 26 BULL. E.C. No. 7 (1993), at 22; 20 BULL. E.C. No. 1 (1987), at 19; *see also* ROBERT MINIKIN, THE ERM EXPLAINED 16-17 (1993); Mehnert, *supra* note 89, at 374; *ERM Parity Grid*, FIN. TIMES, Sept. 15, 1992, at 2.

126. This obligation, undertaken in 1978, is a refinement of the 1972 Basle Agreement, wherein it was agreed that rates would float 4.5% of a fixed rate. *See supra* note 61 and accompanying text.

127. Brussels Resolution, *supra* note 84, art. A3, §§ 1, 6. Technically, the bands are not /-2.25%. To make the value of the grid consistent, the exact percentages are 2.275% and -2.225%. *See* EDWARDS, *supra* note 20, at 537 n.182; GOLD, *supra* note 31, at 159; MINIKIN, *supra* note 125, at 15. The /-2.25% band will be used throughout these examples for simplicity and because the wider band agreed to in August 1993 is said to be temporary. In the example given in the text accompanying note 125, the bilateral mark-to-franc grid rate would be: one mark equals three francs. The permitted trading range thus would be: one mark equals three francs /-2.25%, or one mark equals 3.675 to 2.932 francs. Conversely, the bilateral grid rate for the franc expressed in marks would be: one franc equals .333 marks. The permitted fluctuation of the mark in terms of francs would be .333 /-2.25%, or from .3405 to .3255 marks. The grids published by the Commission in 1987 and 1993 include the bilateral grid rate as well as the maximum and minimum currency values for all of the currency relationships. For ease, single currency units are not used for many of the currencies. For example, the computations are done using 100 Belgian/Luxembourg francs, 100 Danish krones, 100 French francs, 1 German mark, 1 Irish pound, 1000 Italian lira, 100 Dutch guilders, 100 Portuguese escudos, 100 Spanish pesetas, and 1 British pound. *See supra* text accompanying

the central banks agreed to a straight-forward but substantial modification of that commitment. The permitted bands of fluctuation were increased at that time to /-15% of the bilateral grid rates.[128] All other aspects of the ERM procedures and obligations remain as they were.

While this obligation to assure that the value of the currency remains within the permitted band differs from that which the Member States have as members of the IMF,[129] the Brussels Resolution notes that the EMS — including the ERM — is and will remain compatible with the obligations under the IMF.[130] Such an arrangement is specifically allowed by the IMF Articles.[131]

A divergence indicator is used to forecast the need for governmental action to restore the relationship. The divergence indicator is the percentage of variation in bilateral rates from the fixed bilateral grid rates. The "threshold of divergence" is crossed when the market rates of a particular currency relationship are at roughly 75% of the maximum allowable divergence, that is roughly 75% of the /-2.25% or now 15%, of the fixed bilateral grid rate.[132] At this point, the two countries are encouraged, but not obliged, to act. This encouragement is rather obliquely stated. The Brussels Resolution indicates that when the threshold of divergence is reached there "results . . . a presumption that the authorities concerned will correct the situation by adequate measures. . . ."[133] When the divergence is at 100% — that is, when the value of the currencies are at or outside the established bands of /-2.25% or now 15% — the countries are obliged to intervene to bring the values within the prescribed range.[134]

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note 125.

128. 26 BULL. E.C. No. 7-8 (1993), at 21-22. In all other respects, the procedures of the ERM remain as they were prior to that date. This change was in response to the summer currency crisis when several currencies, including the French franc and the Danish krone, were at or outside the permitted bands. It was uncertain whether the governments could correct their values, and it seemed possible that the ERM would collapse as a result. This modification was thought to be a less undesirable course. *See* James Blitz, *Move Amounts to Suspension of System*, FIN. TIMES, Aug. 2, 1993, at 1; Peter Marsh & Lionel Barber, *EC Mounts ERM Rescue Bid*, FIN. TIMES, Aug. 2, 1993, at 1. The communique announcing the agreement to make the change stated that it was a temporary measure made in response to the extraordinary speculation against the effected currencies. 26 BULL. E.C. No. 7-8 (1993), at 21.

129. See *infra* note 153 and accompanying text.

130. Brussels Resolution, *supra* note 84, art. A5, § 3.

131. International Monetary Fund Agreement, 2 U.N.T.S. 29, art. IV, § 2(b)(ii) [hereinafter IMF Agreement]; EDWARDS, *supra* note 20, at 536; *see infra* note 152 and accompanying text.

132. Brussels Resolution, *supra* note 84, art. A3, § 5; Central Bank Agreement, *supra* note 87, art. 3.1. The "threshold of divergence" is not reached at precisely 75%. The ECU basket is the indicator of the threshold. Brussels Resolution, *supra* note 84, art. A3, § 5. But the currency in question must be eliminated from the value of the ECU as used for this computation. A formula determines the exact threshold point: .75 x 2.25 (or 6) (or 15) x 1, minus the currency's weight in the ECU basket. *See* EDWARDS, *supra* note 20, at 543 n.203.

133. Brussels Resolution, *supra* note 84, art. A3, § 6.

134. *Id.* art. A3, § 4; Central Bank Agreement, *supra* note 87, art. 2.2.

III. Issues and Comments on Present System

The essence of the ERM then is simply an effort to attain a stable currency relationship by obliging the participants to maintain the free market value of their currencies within fixed relationships to one another. There are numerous points to be made regarding this superficially quite straight-forward obligation. The first is to acknowledge the serious nature of the August 1993 announcement. If the purpose of the ERM is to force the confluence of exchange rates and stable currency relationships to ease the transition to a single currency as envisioned by the Treaty on European Union,[135] such a goal is significantly undercut by this change. An allowable fluctuation of up to 30% (/-15%) around a fixed base hardly forces stable or very close currency relationships. Thus, the goals of the Treaty on European Union are seriously undermined, as are the prior thirty years of effort toward that goal.[136] While the structure of the ERM remains intact, the allowable bands hardly require much action to encourage confluence.

Nonetheless, structurally the ERM remains as it was before August 1993. The ERM remains a set of bilateral obligations, the obligation of each participating Member State is to keep the market value of its currency within the bands established for each participating currency. It is unclear, however, whether this obligation is a matter of Community law and is enforceable as such.

Prior to the Single European Act, the legal status of the ERM was unclear. The Brussels Resolution is an agreement among members of the European Council. This body was not a Community institution, and it had no role in Community-law making.[137] There was no reference to the ERM in the Treaty of Rome, and the entity making it had no status as a Community law making body. The Brussels Resolution did request the Council of the Communities to take actions necessary to implement the ERM,[138] and the Coun-

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135. *See* Delors Report, *supra* note 9 and accompanying text.

136. In the communique announcing this change, the finance ministers and central bank governors emphasized the temporary nature of this modification as a response to extraordinary speculation and reaffirmed their determination to put the Treaty on European Union into effect as soon as ratification was complete. 26 Bull. E.C. 7-8 (1993), at 21. The Commission, in a communique issued on August 6, 1993, in response to the action, noted the gravity of the modification and the consequences for the economic and monetary union. *Id.* at 23. However, there is no immediate rush to return to the narrower margins. In fact, quite the opposite has transpired. In October 1993, the finance ministers and central bank governors of the Member States determined that the wider band would remain in place for the foreseeable future. Barber, *supra* note 12, at 1; *see also* Blitz, *supra* note 128, at 1; Peel, *supra* note 12, at 1.

137. *See generally* David A.C. Freestone & J. Scot Davidson, The Institutional Framework of the European Communities 56-57 (1988); Dominick Lasok & John W. Bridge, Law and Institutions of the European Communities 244-46 (5th ed. 1991); Stephen Weatherill & Paul Beaumont, EC Law 73-78 (1993); Daniel T. Murphy, *European Political Cooperation After the Single European Act: The Future of Foreign Affairs in the European Communities*, 12 B.C. Int'l & Comp. L. Rev. 335, 338-39 (1989).

138. Brussels Resolution, *supra* note 84, art. A6, § 1.

cil did so.[139] Hence, some of the implementing measures are clearly matters of Community law. However, the core of the ERM — is the commitment to defend currency values within the stated margins — is contained in quasi-Community documents; and the Council was not requested to take action with respect to it.[140] Thus, the legal status of its pronouncements or agreements was vague. The Single European Act added article 102(a) to the Treaty of Rome.[141] Article 102(a) referred to the EMS and the ECU.[142] The Single European Act did not add the European Council as one of the Community institutions or grant it a role in the Community-law making process, but there was reference to the EMS in the Treaty. Arguably, this was sufficient to obligate the members participating in the ERM to fulfill their obligations as a matter of Community treaty law.[143]

The Treaty on European Union amended the Treaty of Rome to replace Article 102(a).[144] Article 102(a) as amended in the Treaty on European Union contains no reference to EMS or the ERM.[145] Moreover, the European Council — while assigned several roles — is not elevated as a Community law making institution.[146]

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139. *Id.*; *see, e.g.*, Regulation Changing Value of EMF Unit, *supra* note 86 (creating the ECU, thereby implementing art. A2, § 3, of the Brussels Resolution); Decision Amending Medium-Term Financial Assistance, *supra* note 85 (increasing the amount of medium-term financial assistance, as a source of funds from which Member States' obligations could be met, as provided in art. A4, § 4, of the Brussels Resolution); Regulation Relating to European Monetary System, *supra* note 87 (broadening the authority of the EMCF).

140. Rey, *supra* note 87, at 10.

141. EEC TREATY art. 102(a) (as amended 1987).

142. Article 102a reads as follows:

> In order to ensure the convergence of economic and monetary policies with is necessary for the further development of the Community, Member States shall cooperate in accordance with the objectives of Article 104. In so doing they shall take account of the experience acquired in cooperation within the framework of the European Monetary System (EMS) and in developing the ECU, and shall respect existing powers in this field.

Id.

143. Clearly, the first sentence of article 102a obligated Member States to cooperate to achieve the objectives of article 104. But the second sentence, wherein reference is made to the EMS and the ECU, is very oblique — so oblique, in fact, that it may not contain an obligation. The sentence apparently means that in the course of cooperating in accordance with article 104, the parties shall take into account the experience in cooperation acquired within the EMS. This hardly creates an obligation to comply with the EMS obligations. *But see* GOLD, *supra* note 31, at 140; Louis, *supra* note 81, at 11, 26; Usher, *supra* note 91, at 259.

144. EC TREATY art. 102a (as amended 1993).

145. Article 102a, as amended by the Treaty on European Union, reads as follows:

> Member States shall conduct their economic policies with a view to contributing to the achievements of the objectives of the Community, as defined in article 2, and in the context of the broad guidelines referred to in article 103(2). The Member States and the Community shall act in accordance with the principle of an open market economy with free competition, favoring an efficient allocation of resources, and in compliance with the principles set out in article 3a.

Id.

146. Under the Treaty on European Union, the tasks of the Community are still entrusted to the Parlia-

The progress toward monetary union envisioned in the Treaty on European Union is to be accomplished in stages. During the second stage, which under the Treaty is to commence January 1, 1994,[147] four conditions are to be met before the members can proceed to complete monetary integration, including the single monetary policy, single central bank and single currency. Among these four conditions, two refer to the EMS and the ERM.[148] The Member States are to have observed the normal fluctuation margins of the ERM, without devaluation, for two years.[149] Also the durability of the convergence of monetary policy of the members achieved through participation in the ERM must be evidenced by the level of long term interest rates.[150] It is not clear whether these references state a Community law obligation to comply with the ERM procedures. The references are in the section of the Treaty setting out conditions before the members can proceed to the third stage of monetary union, and participation in the ERM itself remains voluntary.[151] It is thus unlikely that the ERM obligations are enforceable by Community institutions, such as the Commission.

Regardless of whether the ERM obligations are considered matters of Community law or some other form of international undertaking, these obligations would be owed to all participating members of the ERM, not just to the other side of the bilateral grid relationship. Since participation among EC members in the ERM is voluntary, the obligation would appear not to be owed to the non-participating EC members.

The obligation of each participant is to maintain the value of its currency within the permitted bands in relation to the other currencies, not in relation to the ECU, or some other external entity. Under the Bretton Woods Agreement, there existed a set of currency par values in relation to the value of gold or the U.S. dollar, and a set of unilateral obligations whereby the signatories agreed to maintain the value of their currencies at a value within 1% of the established par value.[152] Under the ERM there are bilateral obliga-

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ment, Council, Commission, Court of Justice, and Court of Auditors. In addition, the Treaty on European Union created a European System of Central Banks, European Central Bank, and a European Investment Bank. TEU art. D. This treaty assigns the European Council two roles, one generally and one specifically. In general, it is to provide the Community (now Union) "with the necessary impetus for its development and shall define the general political guidelines." TEU art. D. More specifically, the Council is to play a role in economic policy. The Council, upon recommendation from the Commission, is to formulate the broad outline of guidelines for the economic policies for the Member States and the Community. It is to submit this draft to the European Council. The European Council is to reach a position on the draft. Based on its conclusion, the Council of the Community (or now Union) can proceed to adopt the guidelines. EC TREATY art. 103 (as amended 1993).

147. EC TREATY art. 109e (as amended 1993).

148. *Id.* art. 109(j)(1)(as amended 1993).

149. The August 1993 widening of the margins was subsequent to the signing of the Treaty on European Union. This condition in article 109j(1) must refer to the old margins.

150. EC TREATY art. 109(j)(1) (as amended 1993).

151. *See supra* text accompanying note 115.

152. IMF Agreement, *supra* note 131, art. IV, § 4(b). This is the version of the IMF Articles adopted at

tions. In the simple example previously given, the value of the german mark expressed in french francs is 3 french francs (the bilateral grid rate would show this as the value of marks expressed in francs). Since the obligation of each participant is to keep its currency within the permitted bands in relation to another currency, one currency cannot be in disequilibrium. If the value of the franc were to slip so that one mark were worth 4 francs, upon which country would the obligation to take corrective action fall? The logic of the bilateral grid is that both countries are obliged to intervene. Both currencies are either within or without the permitted bands,[153] and thus the obligation would fall on both to correct the imbalance. Germany would be required to act to reduce the value of the mark in relation to the franc and France would be required to act to raise the value of the franc in relation to the mark.[154] Since the bilateral grid rates show the maximum and minimum value of a currency in relation to another, and since both currencies float, there is a bilateral obligation to maintain the currency relationship. Under the Bretton Woods Agreement, there were only unilateral obligations to maintain the specified value in relation to gold or dollars. These bilateral grid relationships show the genius of the ERM. The participants are bound together in monetary policies. As a consequence of the policies causing the franc to weaken, not only is France obliged to take corrective action, but Germany is as well. France should consider the effects of its policies on Germany, and Germany legitimately has standing to be heard regarding them.

The constitutive documents are not precise on the extent of this obligation, except that it is not unilateral. The Brussels Resolution states that when the threshold of divergence (75% of maximum divergence) is reached there

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Bretton Woods in 1944. *See generally* EDWARDS, *supra* note 20, at 8-9 nn.15-16, 491-531. The current obligation regarding exchange arrangements generally require consultation and cooperation in achieving stable exchange rates. Since currencies are no longer assigned par values, there is no obligation to defend a currency's value. Second Amendment to the Articles of the International Monetary Fund, Apr. 30, 1976, 29 U.S.T. 2204, 2208. *See generally* EDWARDS, *supra* note 20, at 502-71.

153. In the simple example accompanying note 125, the bilateral grid rate would be one German mark to three French francs, the correlative would be one franc equals .333 marks. If the bands were /- 2.25%, the maximum and minimum allowable currency values would be: one mark equals 2.32 to 3.675 francs; and one franc equals .3227 to .3374 marks. If the franc were to slip so that one mark would equal four francs, the correlative would be one franc equals .25 marks. Thus, both currencies would be outside the permitted bands.

154. During the summer of 1993 currency crisis involving the franc, this took place. The franc declined more than 75% of the allowed divergence from the fixed value in relation to the mark. The Bundesbank intervened to purchase francs. John Riding & Emma Tucker, *German Support Fails to Halt Franc's Decline*, FIN. TIMES, July 13, 1993, at 1; *Germany Supports Franc*, FIN. TIMES, July 13, 1993, at 27. However, during the September 1992 crisis involving the British pound, the onus seemed to be on the British government, with little help from the German Bundesbank. *See* Ivo Dawney, *Britain Blames Bundesbank*, FIN. TIMES, Sept. 17, 1992, at 1; Stephens, *supra* note 117, at 1. British ire was mostly directed at the Bundesbank's failure to reduce German interest rates rather than at the failure to sell marks and purchase pounds. Dawney, *supra*, at 1.

will be a presumption that "the authorities concerned"[155] will correct the situation. In instances of mandatory intervention, when maximum divergence is reached, "intervention in participating currencies is compulsory."[156] In neither setting are the intervenors specifically identified. That the "intervenors" include both Member States to the particular bilateral grid relationship is evident. Although all EC Member States, even those not participating in the ERM, are obliged to assist the affected states through currency loans,[157] it is not clear whether participating ERM countries not parties to the particular bilateral grid relationship are obliged to intervene with the purchase or sale of the currencies in question.[158] The Central Bank Agreement does not clarify this point. In fact the obligation in this regard is so obliquely stated that it is entirely unclear upon which Member States the obligation does lie. The Central Bank Agreement simply states that "[i]ntervention shall in principle be effected in the currencies of participating central banks."[159]

The Brussels Resolution appropriately does not identify the entity or entities within each Member State responsible for carrying out the country's ERM obligations. Article 3.6 provides that when the threshold of divergence is reached, there is a presumption that "the authorities concerned"[160] will take the specified forms of corrective action, while at the compulsory intervention point, it simply states that "intervention is mandatory."[161] The Central Bank Agreement is no more explicit. It does not identify the currency intervenors. It provides only that interventions generally are to be in the currencies "of participating central banks."[162] This is an agreement among central banks, and most of its obligations are stated in terms of "participating central banks."[163] The Central Bank Agreement treats only intervention, creation of the ECU and the financing of intervention and other ECU transactions. In so far as it relates to the ERM, all its obligations understandably are those of the central banks. There is no reference in this agreement to other means of correcting currency disequilibriums. At the threshold of divergence

155. Brussels Resolution, *supra* note 84, art. A3, § 6.

156. *Id.* art. A3, § 4.

157. *See infra* note 187 and accompanying text.

158. During the summer of 1993, when the French franc and Danish krone surpassed the 75% threshold of divergence against the German mark, there was intervention in the currency markets by at least one other central bank. The Dutch central bank purchased francs and krones in an effort to boost their value. *Pressure on Franc and Krone*, FIN. TIMES, July 15, 1993, at 1; *see No Holiday for the ERM*, FIN. TIMES, July 15, 1993, at 24.

159. Central Bank Agreement, *supra* note 87, art. 2.2.

160. Brussels Resolution, *supra* note 84, art. A3, § 6.

161. *Id.* art. A3, § 4.

162. Central Bank Agreement, *supra* note 87, art. 2.2.

163. *See, e.g., id.* art. 2.1 (participating central banks are to notify the Secretariat of the Committee of Governors of the rates for compulsory intervention); *id.* art. 3.1 (participating central bank shall establish rates for its currency constituting the threshold of divergence); *id.* art. 6.1 (participating central banks shall open very short-term credit facilities to finance interventions).

(75% of maximum) many corrective measures other than currency interventions are not entirely within the central banks' authority. The question of who are a participating Member State's appropriate actors is confused in part because of the differing relationships of the central banks to the governments.[164]

The bilateral obligation in any instance of disequilibrium should reinforce the mutual dependence among participating states. The consequence of any state's particular monetary policies on other states must be taken into account. The permitted fluctuation band encourages a country not to allow its currency to become too strong relative to one or more of the participating currencies, just as well it encourages a country not to allow its currency to become too weak. While this mutual dependance — or at least mutual concern — should serve to reinforce the notion of interdependence within the Community, it is just as likely, or perhaps more so, that it is a source of friction and disharmony.[165]

Given the evolution during the 1970s from individual Member State action to Community based initiatives regarding monetary policy,[166] it is surprising that the constitutive documents contain no procedures or requirements for concerted action to bring currencies back within the bands.[167] Both the Brussels Resolution and the Central Bank Agreement speak in terms of action by the relevant governmental entities, but they seem to contemplate unilateral action.[168] No provisions are made for collaborative action or indeed for consultation and coordination of the unilateral action.

The central rate ECU is simply a medium through which the bilateral exchange rates grid is computed. It has little other function. The bilateral grid

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164. The Bundesbank is completely independent from the German government. At the other extreme, the Bank of England is an agency of the government.

165. In September 1992 the British pound came under substantial pressure in relation to the mark. The pound was weak for various reasons, including the effects of a recession and high unemployment. The government lowered interest rates to stimulate the economy, which had the effect of decreasing the value of the pound. Germany was pursuing a high interest rate policy to combat inflation caused in part by reunification. Both countries, for legitimate domestic purposes, were pursuing inconsistent policies. The consequence was a considerable strain on the ERM rates between the mark and the pound. Britain expended significant sums defending the pound by purchasing pounds with marks and other currencies. Germany did not reciprocate by selling marks for pounds or by lowering interest rates. The mutual obligations were not honored and became a source of friction. *See* Ivo Dawney & Robert Graham, *Major Calls for ERM Reform*, FIN. TIMES, Sept. 19-20, 1992, at 1; Dawney, *supra* note 154, at 1; Quentin Peel, *Sterling Plight Not Our Fault Bonn Insists*, FIN. TIMES, Sept. 18, 1992, at 2; *see also* Alice Rawethorn, *Franco-German ERM Rift Denied by Finance Ministers*, FIN. TIMES, Aug. 4, 1993, at 1.

166. *See, e.g., supra* notes 48-59, 61-76 and accompanying text.

167. Other than the obligation to loan EMCF funds for currency intervention. See *infra* note 187.

168. Brussels Resolution, *supra* note 84, art. A3. "Intervention in participating currencies is compulsory when the intervention points defined by the fluctuation margins are reached." *Id.* art. A3, § 4. "When a currency crosses its 'threshold of divergence,' this results in a presumption that the authorities concerned will correct this situation by adequate measures." *Id.* art. A3, § 6. "Interventions shall in principle be effected in currencies of the participating central banks." Central Bank Agreement, *supra* note 87, art. 2.2.

rate and the maximum/minimum divergence from that grid rate are expressed directly in the currencies in question, not in ECU's. It is intended that the central rates and maximum/minimum divergence bands be public.[169] These intervention points should serve to narrow the market exchange rate fluctuations since they would designate at the extremes the points at which the Member States will take corrective actions to maintain the stated margin. It is thought that this stability will also stabilize the value of the ECU.[170] Such stability would only be of a "second generation," however. The general purpose ECU is a composite of the stated portions or weights of EC member currencies and its value is computed in relation to the dollar.[171] The goal of the ERM is to achieve some reasonable stability among the participating currencies themselves. Their stability in relation to the dollar will also depend on the market value of the dollar itself.[172]

While the common knowledge of the divergence points forces stability by establishing the points at which government action is required, it also enables the free market to test those limits by speculating against the currency with the knowledge that the government will intervene to prop up its value. Such speculation can intensify the downward spiral.[173]

When the 75% threshold of divergence is reached, there are a variety of countermeasures which may be taken to bring the currency value back toward the bilateral grid rate. The Brussels Resolution notes that when the threshold of divergence is reached the authorities concerned will correct this situation by the following measures: i) intervention; ii) measures of domestic monetary policy; (iii) change in central rates; and (iv) other measures of economic policy.[174] At this point, 75% of maximum divergence, the situation has not reached the absolute limits. It is thought that there is time for the various corrective measures to take hold and for the market rates 'to become closer to the bilateral grid rates. The first two of these measures are unilateral in character, even though both sides to the parity grid relationship could take them. Direct intervention in the currency markets ought to have an immediate effect on the bilateral rates. Domestic monetary policy mea-

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169. The central banks are to notify the secretariat of the Committee of Governors of the Central Banks of the maximum and minimum intervention points as computed from the bilateral rate grid, and the market shall also be notified of this. Brussels Resolution, *supra* note 84, art. A2, § 1.

170. SUNT, *supra* note 91, at 13.

171. *See supra* notes 102-03 and accompanying text.

172. This demonstrates the reverse of the proposition that the U.S. economy is in part dependent on the monetary policy among the EC countries. The value of the various EC currencies in terms of the dollar is in part dependent upon interest rates here and the other aspects of economic and monetary policy of the U.S. government and the Federal Reserve System.

173. *See, e.g.*, Peter Marsh et al., *Future of ERM in Balance*, FIN. TIMES, July 31-Aug. 1, 1993, at 1 (noting that George Soras had changed his position and was not willing to speculate against the franc); John Ridding & David Buchann, *Embattled Franc Fort Ready to Pull up Drawbridge*, FIN. TIMES, Sept. 14, 1993, at 1.

174. Brussels Resolution, *supra* note 84, art. A3, § 6.

sures include changes in central bank lending rates. They likewise ought to have the market effect of changing the currency's market value quickly. Other domestic economic policies, such as the government's spending policy, would have a less discernible and probably more gradual effect on the market value.

The third corrective measure, a change in the central rates, requires concerted action and agreement of all participating Member States and the Commission.[175] Such a measure is likely to be requested in the instance of a weak currency and may involve considerable political embarrassment. In a sense, correction of the imbalance by adjustment of the central rates is an admission of failure. It may entail a readjustment of the central rates to a value close to the market rate. It is thus taking corrective action by agreeing that the new fixed parity grid rate will be the former market rate, which was outside the bands of the former grid rate.[176] Yet there may be incentive among the other members to agree to a request for such a change, because the alternative may be for the member to withdraw from the ERM and allow its currency to float freely. However, by acceding to the change in rates, the other states run the risk that the free market rates of their currencies in relation to the currency in question will be farther above the new central rate. The fact that, within the ERM, changes in central rates can be effected only with the consent of the other states supports the notion that there are broadly based obligations among the ERM participants to defend the currencies of other participants.

When 100% of maximum divergence from the central rates is reached, corrective action must be taken, and such action must be through currency intervention.[177] Because of the immediate effect direct currency intervention has in altering market value, intervention should quickly bring the currencies

175. The Brussels Resolution provides that central rate adjustments are subject to agreement by common procedure involving all participating currencies and the Commission. *Id.* art. A3, § 2. In 1990 Italy reduced the bands of fluctuation for the lira from 6% to 2.25%. This required a devaluation of the lira and an adjustment of all of the central rates. 23 BULL. E.C. No. 1 (1990), at 11. Likewise, in September 1992 the Italian government devalued the lira in an ultimately unsuccessful effort to ease pressure on the lira. 25 BULL E.C. No. 9 (1992), at 12. *See Lira Devalued 7% in EMS*, FIN. TIMES, Sept. 14, 1992, at 1. Within a week, the Italian government announced that it would not intervene in the currency markets. 25 BULL. E.C. No. 9 (1992), at 22.

176. EC Treaty article 109(j) requires, as a condition of moving to the final stage of monetary union, observance of the ERM bands for two years without resort to devaluation. EC TREATY art. 109(j) (as amended 1993). This condition illustrates one reason that the Treaty on European Union's January 1, 1999 deadline for monetary union is optimistic. This condition presumes that all Member States are ERM participants, which is not presently the case. Moreover, there is no obligation to participate. Britain and Denmark will not participate in the final stage of monetary union unless they specifically agree to do so. EC TREATY protocols 11, 12 (as amended 1993). In the event they do not, they are eliminated from the assessment of whether the conditions referred to in article 109(j) are met. Greece and Italy have no such opt-in privilege.

177. Brussels Resolution, *supra* note 84, art. A3, § 4.

back within the permitted margins.[178]

Generally currency interventions are to take place in the currencies of the participants, principally those of the parties to the particular bilateral grid rate relationship which is in disequilibrium; but this is not an exclusive requirement.[179] The constitutive documents are unclear and inconsistent on this point. The Brussels Resolution notes that "in principle intervention are to be in participating currencies."[180] The next section provides that "[i]nterventions in participating currencies is compulsory when the intervention point defined by the fluctuation margins are reached."[181] This section can be interpreted to mean both that intervention is compulsory at 100% of divergence, and that intervention in participating currencies is compulsory at that point. The Central Bank Agreement provides, like the Brussels Resolution that "[i]nterventions shall in principle be effected in currencies of the participating central banks. These interventions shall be unlimited at the compulsory intervention rates."[182] The Central Bank Agreement supports the notion that all interventions, compulsory or discretionary, "in principle" are to be in the currencies of participating Member States, but not necessarily so. The Brussels Resolution, while ambiguous, can be read to reach the same conclusions. In fact, interventions, particularly non-mandatory interventions (at 75% of maximum divergence) are often made in other currencies, in particular the U.S. dollar.[183] Moreover, it is likely that interventions, if made in participating currencies, would be made in the currencies of the parties to the bilateral grid relationship in question. However, language from the Brussels Resolution and the Central Bank Agreement supports the con-

178. Enormous sums were spent in the summers of 1992 and 1993 in efforts to prop up the British pound and French franc. In early summer 1992, Britain spent over $2 billion defending the pound. Colin Narbrough, *Reserves Are Depleted in Support for Sterling*, THE TIMES (London), Sept. 3, 1992, at 1. In September 1992 Britain borrowed £7.25 billion, mostly in German marks, from a group of international banks. It intended to use this "war chest" as the fund with which to defend the pound rather than deplete its own foreign currency reserves. Michael Clarke & Colin Narbrough, *Lamont Guards Sterling with 7.25 Shield*, THE TIMES (London), Sept. 4, 1992, at 1. European central banks spent an estimated 50 to 70 billion German marks (£19-27 billion) to prop up the French franc, Belgian franc and the Danish krone in 1993. Marsh, *supra* note 173, at 1. These government interventions were not successful. Britain withdrew from the ERM because it could no longer afford the financial and political costs of intervention. *See* Stephens, *supra* note 116, at 1. The ERM bands were widened in part because the sums France expended did not sufficiently raise the franc's value. *See* Marsh & Barber, *supra* note 128, at 1.

179. If the German mark/French franc bilateral grid rate exceeded maximum divergence, the sale of marks for currencies other than francs ought likewise increase the supply of marks and reduce its value overall, including its value against the French franc. The Brussels Agreement states that the interventions are to be made in participating currencies. Brussels Resolution, *supra* note 84, art. A3, §§ 3-4. This would rule out the use of non-participating currencies such as the dollar. It is not stated that intervention is to be only in the currencies of the two countries to the particular grid relationship. The Central Bank Agreement similarly omits any such statement. Central Bank Agreement, *supra* note 87, art. 2.2.

180. Brussels Resolution, *supra* note 84, art. A3, § 3.

181. *Id.* art. A3, § 4.

182. Central Bank Agreement, *supra* note 87, art. 2.2.

183. GOLD, *supra* note 31, at 154-55.

clusion that intervention can be in other participating currencies as well.

The means whereby ERM currency interventions can be funded are likewise set out in the constitutive documents. The Brussels Resolution and the Central Bank Agreement provide that a very short term credit facility be established in unlimited amounts to serve as a source of any necessary external funding of currency interventions.[184]

At the point of maximum divergence, (100% of maximum divergence) a Member State's obligation is to take corrective action through currency intervention.[185] This obligation is without limit; the Member State is obliged to intervene in whatever amount is necessary to bring its currency within the band.[186] The very short term credit facility established in the Brussels Resolution and the Central Bank agreement provides the means to accomplish such intervention, again in unlimited amounts. Under the terms of the very short term credit facility, the member bank of each Member State agrees to open an on demand line of credit in an unlimited amount of its own currency in favor of each ERM participating central bank.[187] If a country is required to intervene to bolster its currency in terms of another currency, it will purchase its own currency on the open market with the other currency. The open market amount of its currency is lessened, increasing the value of that which remains. The open market supply of the currency of intervention is increased, thereby lessening its value. Both currencies in any ERM bilateral grid relationship are either in mutual equilibrium or disequilibrium.[188] If the intervening country uses as the currency of intervention that of the other party to the particular bilateral grid relationship, the effect should be that both currencies will move back within the band. The currency being purchased on the market will increase in value, and that used to make the purchases will decrease. In making these purchases, the intervening country is satisfying the obligations of both parties to the particular grid relationship, but at its own expense.[189]

184. Brussels Resolution, *supra* note 84, art. A3, § 7; Central Bank Agreement, *supra* note 87, art. 6. *See generally* EDWARDS, *supra* note 20, at 326-32; GOLD, *supra* note 31; at 152-60. Other Community-based monetary support programs and facilities are also available for this purpose. *See generally* EDWARDS, *supra* note 20, at 332-41.

185. Brussels Resolution, *supra* note 84, art. A3, § 4.

186. *See supra* note 134 and accompanying text.

187. All Member States, except Greece, are parties to this obligation. Since the purpose of this credit facility is to finance ERM-dictated currency interventions, those Member States not participating in the ERM may not draw against this facility. Under its terms, they may be obliged to loan amounts of their currencies, with interest. EDWARDS, *supra* note 20, at 327.

188. *See supra* note 153 and accompanying text.

189. Typically, the onus to make these purchases has fallen on the weak currency countries. Both Britain and France bore the brunt of making these purchases against the mark. *See infra* note 178 and accompanying text. In making these purchases, the government will either expend its own reserves of the currency of purchase, or it will borrow this currency from international banks or through the EMCF. *See supra* note 178 and accompanying text; *infra* notes 190-92 and accompanying text.

Functionally, the central bank requiring the other currency (the "borrowing bank") may obtain the currency through the medium of the EMCF. The bank providing the currency (the "issuing bank") receives from the EMCF in exchange an amount of ECUs equal to the market value of the national currency committed.[190] The borrowing bank's "account" with the EMCF is charged in a like amount of ECU's.[191] While the amount of a borrowing bank's obligation to the EMCF and the EMCF's obligation to the issuing bank are stated in ECU's, the repayments themselves are in the currency of the borrowing state, the lending state or another national currency.[192] The appellation very short term credit facility is a slight misnomer. Repayment is due on the sixteenth day of the third month following the intervention,[193] and repayment can be extended under certain circumstances.[194]

As a means of funding this credit mechanism, as well as for other purposes, the Brussels Agreement establishes a fund within the EMCF. Each participating central bank contributes 20% of its gold holds and 20% of its dollar reserves to the EMCF in exchange for ECUs. These contributions are by way of three month renewable swaps, which can be unwound on two days notice.[195]

IV. CONCLUSION

The ERM as outlined in this piece continues in place and functions. Since the changes in the intervention bands announced in September 1993, the ERM has entered a period of quiescence. The system now functions with little public awareness because the resetting of the intervention bands has relieved the intense intervention pressure. This supposedly temporary measure means that there will be little need for intervention, as the new intervention points allow significantly wider bands. Although these changes did not alter the structure of the ERM, its role as a device to force stable and close currency relationships as the prelude to monetary integration has suffered a tremendous setback.

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190. The amount of ECUs is the market value of the ECU in the currency committed at the daily market rate on the date of intervention times the amount of national currency committed.

191. Central Bank Agreement, *supra* note 87, arts. 6, 7; EDWARDS, *supra* note 20, at 328.

192. The obligations are denominated in ECUs. Changes in the value of the ECU as against the currency of payment will affect the actual amount of the payment. EDWARDS, *supra* note 20, at 328-31.

193. Central Bank Agreement, *supra* note 87, art. 9.

194. *Id.* art. 10.

195. Brussels Resolution, *supra* note 84, art. A3, § 8; Central Bank Agreement, *supra* note 87, art. 17.