
Group of Experts under the
chairmanship of M. Heyvaert

Revised text*

No. 42

ADJUSTMENT OF VERY SHORT-TERM AND SHORT-TERM
COMMUNITY CREDIT ARRANGEMENTS WITH A VIEW TO THE IMPLEMENTATION OF
THE NEW EUROPEAN MONETARY SYSTEM



In pursuance of the mandate given to it by the Committee of Governors following the Council meeting on 18th September 1978, the Group of Experts studied the question of how the existing reciprocal credit arrangements could be extended with a view to the implementation of the new European monetary system.

I. BASIC PREMISES

The Bremen communiqué envisages the creation of an initial supply of ECUs against the deposit by member countries' central banks of, on the one hand, reserve instruments (dollars and gold) amounting to, for example, 20 per cent. of their reserve holdings and, on the other hand, national currencies of a comparable amount. The issue of ECUs against national currencies could provisionally be replaced by an enlargement of the existing credit machinery, which, under the terms of the Bremen communiqué, is to be consolidated in a European Monetary Fund not later than two years after the entry into operation of the system.

In his oral report to the Council of Ministers on 18th September 1978, the Chairman of the Committee of Governors stated in this connection that:

"At this stage of their work, the Governors do not feel they are in a position to express a clear-cut and final opinion on the structure, scale and duration of the credit arrangements that would be required for the new European monetary system to function smoothly. They are examining

* Text revised according to the corrigenda of 6th October 1978, which were circulated at the meeting of the Committee of Governors on 9th October 1978.

this matter in the context of their study of the European Monetary Fund and in the light of the possible characteristics of the exchange rate system.

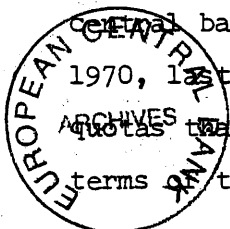
It is clear, however, that the European Monetary Fund cannot be set up at short notice, i.e. by the time the exchange rate system is introduced, whereas that system will require substantially larger credit facilities than those existing at the moment. It follows that during a transitional period the monetary system would have to operate on the basis of enlarged credit arrangements which would be incorporated in the Fund later, when the new institution has been established and entrusted with the task of granting and administering the arrangements for reciprocal financial assistance."

II. PRESENT STRUCTURE OF THE VERY SHORT-TERM, SHORT-TERM AND MEDIUM-TERM CREDIT FACILITIES

The envisaged adjustment of existing facilities so as to enable the new exchange rate system to function smoothly and effectively encompasses the very short-term intra-Community facilities, the Agreement concerning short-term monetary support concluded by the central banks and the machinery for medium-term financial assistance.

At present the very short-term intra-Community facilities (VSTF) enable a central bank that has had to carry out interventions in Community currencies under the European monetary "snake" arrangements to obtain financing that is unlimited in amount but limited in duration (30 days from the end of the month). The automatic renewal facility, whereby the debtor can request the extension of this maturity by up to three months, is in turn limited in volume to an amount corresponding to the debtor quota of the debtor central bank under the short-term monetary support arrangements. A further three-month extension, as well as renewal beyond the quota ceiling, may be obtained by mutual agreement.

The short-term monetary support system (STMS) was set up among the central banks of the EEC member countries by an agreement dated 9th February 1970, last amended by an instrument dated 13th December 1977. The debtor quotas that determine the amount each central bank may receive under the terms of the agreement currently total EMUA 2,725 million; the creditor



quotas amount to a total of EMUA 5,450 million and the creditor and debtor rallonges total EMUA 3,000 million. As a general rule, no central bank may obtain more than half the total debtor rallonges, but the Governors may waive this limit if the special situation and particular needs of the applicant so warrant. The facilities made available to the beneficiary central bank are granted for a period of three months, but may be renewed once for a further three-month period if the beneficiary central bank so requests.

The machinery for medium-term financial assistance (MTFA) was established by a Decision of the Council of the European Communities of 22nd March 1971, and was last amended by a Decision of the Council of 19th December 1977. The credit facilities granted in this context may have a term of between two and five years, and they are conditional on commitments by the beneficiary member country aimed at restoring domestic and external economic equilibrium. Total commitment ceilings at present amount to EUA 5,450 million. In practice, medium-term financial assistance can be used as an extension of the facilities granted within the context of short-term monetary support.

The Group does not consider itself competent to undertake an examination of the adjustments that might be made to the machinery for medium-term financial assistance with a view to its operation during the transitional period. It notes, however, that the envisaged enlargement of short-term monetary support cannot be divorced from enlargement of medium-term financial assistance, and that parallel studies in the two areas are required to obtain an overall view of the enlarged intra-Community credit machinery before the monetary system comes into operation.

In these circumstances, the Group felt that, rather than advance formal proposals, it should confine itself to presenting the results of simulation exercises or a number of working hypotheses relating to the enlargement of intra-Community credit facilities.

III. INITIAL VERY SHORT-TERM FINANCING (VSTF)

The Group considers that this financing facility should remain unlimited in amount.

Most of the members are in favour of extending the duration of the unlimited initial very short-term credit facility from the present 30 days



from the end of the month to 60 or 90 days. In their view, the main effect of any such lengthening of maturities should be to enhance the prospects for a reversal of the debtors' situation, thus enabling them to effect repayments more frequently by repurchasing the creditor's currency in the market.

The rest of the experts see no reason for prolonging the duration of financing as provided for at present in the "snake", for the reasons set out in Report No. 39 (see Section III, D, pages 28 and 29).

The Group proposes that the present facilities for automatic renewal and renewal by mutual agreement should be left intact.

IV. SHORT-TERM MONETARY SUPPORT (STMS)

The majority of the Group consider that the procedures for activating and operating the present agreement - other than those relating to the enlargement of the volume of credit facilities, their duration and the unit of account - should remain unchanged, at least during the transitional period. The Group recalls that requests for support under the agreement may essentially reflect:

- either a desire to extend initial very short-term financing;
- or a need for third currencies.

In the latter case, some central banks might experience difficulties if the amount of their contribution was high.

At all events, any increase in the volume of credit must be compatible with the other provisions of the agreement, notably that requiring the Governors to take appropriate measures to facilitate the mobilisation of claims arising from credit operations.

A. Duration of short-term monetary support

In the light of point 2 of the annex to the Bremen communiqué, a majority of the experts propose that the duration of the facilities available under the short-term monetary support arrangements should be extended to six months, with a renewal facility for a second period of

Six months.



On the other hand, some experts point out that the potential total duration of financing available under the initial very short-term financing and short-term monetary support facilities already exceeds twelve months in both cases, so that there are no grounds for increasing the duration of either of these two types of facility.

B. Volume of short-term monetary support

The first question that arises is: should the figure of ECU 25 billion be adopted as a basic assumption or not?

Most members of the Group accept the figure of ECU 25 billion as a starting-point for discussions concerning a possible increase in short-term monetary support, bearing in mind certain assumptions regarding the amount that might have to be set aside for medium-term financial assistance. These members refer in particular to the Monetary Committee's Report to the Council, which notes that during the transitional period before the setting-up of the Fund the credit system should from the start have at its disposal about ECU 25 billion, independently of the very short-term facility (§ 51 of document II/514/78 - EN (final)).

On the other hand, some experts question this premise which, in their opinion, might unduly influence the volume of the final increase in credit facilities. These experts point out that the proposed figure of ECU 25 billion rests on precarious assumptions such as the participation of all member countries in the exchange rate system and the fixing of a gold price for the contributions of gold against ECUs (given that the amount of ECUs to be created against national currencies will have to be comparable to that of ECUs created against reserve instruments). However, these experts agreed, for the purposes of the discussions, to adopt a working hypothesis based on a doubling of present quotas (and rallonges) but having no bearing on the desired size of the overall volume of credit facilities.

The increase in the credit available under the short-term monetary support arrangements depends not only on the overall amount fixed for the short-term monetary support and medium-term financial assistance facilities combined but also on the choices that are made in response to the following three questions.



Question 1. - Should this overall amount be viewed as the sum of the debtor or creditor quotas and rallonges under the short-term monetary support arrangements and the commitment ceilings under medium-term financial assistance or as the amount of "credit effectively available"?

"Credit effectively available" is to be taken as meaning the maximum amount of credit that can be obtained within the system through an "optimal"* grouping of lenders and borrowers, that is to say one that fully exploits the potentialities of the system. This amount is less, by definition, than the sum of the debtor quotas and rallonges, since all the central banks cannot be debtors at the same time.

Question 2. - How should the overall amount be apportioned between short-term monetary support and medium-term financial assistance?

Question 3. - How should the amount allocated to short-term monetary support be apportioned between the quotas and rallonges? It may be noted in this connection that a proportionally larger increase in the quotas would augment the share of credits available almost automatically, which might be considered to be in line with the final objective of increasing the amount of credit effectively available. On the other hand, an increase in the rallonges would allow greater flexibility in the apportionment of the amounts among potential creditors.

The choices to be made in response to the above questions can, in theory, give rise to an almost infinite number of possible formulae for the enlargement of the scope of short-term monetary support and for the respective increases in quotas and rallonges. Taking into consideration the views expressed, the Group describes below the implications of three working hypotheses reflecting the most common replies given to these questions.

1. The first formula is based, for purposes of illustration, on a doubling of the present debtor and creditor quotas and rallonges, a figure that is not intended to prejudge the overall amount for all short-

* This would occur if the three central banks with the largest quotas, i.e. Germany, the United Kingdom and France, were to draw the whole of their debtor quotas and the whole of the debtor rallonges; the resultant total would represent about 80 per cent. of the sum of the debtor quotas and rallonges.



and medium-term credit facilities. This formula would bring the total of debtor quotas to ECU 6.54 billion, that of the creditor quotas to ECU 13 billion and that of the rallonges to ECU 7.2 billion. Under these circumstances, the amount of credit effectively available under the short-term monetary support arrangements would come to ECU 11.5 billion (ECU 4.3 billion in respect of quotas and ECU 7.2 billion in respect of rallonges).

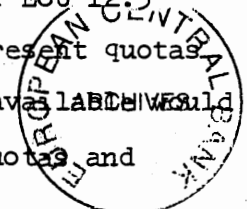
2. The second formula allocates the whole of the overall amount of ECU 25 billion to short-term monetary support, after deduction, however, of the present total of commitment ceilings in respect of medium-term financial assistance, i.e. ECU 5.4 billion. It is based on the assumption that the effective implementation of an increase in these ceilings would take a relatively long time, in view of the necessary institutional procedures.

The balance of ECU 19.6 billion would represent the new total of debtor quotas and rallonges, the increase in the former being greater than that in the latter.

Thus,

- the debtor and creditor quotas would be increased to a total amount of ECU 15 and 30 billion respectively, giving a multiplying factor of 4.5;
- the overall rallonge would be raised to ECU 4.6 billion, representing an increase of less than 30 per cent. compared with the present total;
- using this formula, the credit effectively available under the short-term monetary support arrangements would amount to ECU 14.5 billion (ECU 9.9 billion in respect of quotas and ECU 4.6 billion in respect of rallonges).

3. The third formula is based on the assumption that the whole of the amount of ECU 25 billion would be allocated to short-term monetary support, without prejudice to any subsequent decisions with regard to medium-term financial assistance. The debtor quotas and the rallonges under monetary support would each be increased to a total of ECU 12.5 billion; this gives a multiplying factor of 3.80 for the present quotas and one of 3.47 for the rallonges; the credit effectively available would amount to ECU 20.7 billion (ECU 8.2 billion in respect of quotas and ECU 12.5 billion in respect of rallonges).



4. Some experts propose, in addition, a formula which would imply a substantial adjustment of the operating procedures of the short-term monetary support agreement, since the creditor quotas and rallonges would be eliminated, or at least their restrictive effect would be suspended, and the use of the debtor rallonge would be made rather more flexible. In their view, this would constitute a first step towards adaptation of the system to the new forms of credit and settlement to be introduced in the context of the European Monetary Fund.

The formula would consist essentially of the following elements:

- the size of the two credit arrangements would be doubled; as a result, about ECU 11 billion of the overall amount of ECU 25 billion would be set aside for medium-term financial assistance, the measures required to implement this increase being the responsibility of the governments concerned;
- both the debtor quotas and the debtor rallonges under short-term monetary support would be doubled, giving a total of ECU 13.7 billion (ECU 6.5 + 7.2 billion);
- providing that they had not been used up, each central bank could draw almost automatically on the debtor rallonges an amount corresponding to 150 per cent. of its increased debtor quota;
- the creditor quotas and rallonges would no longer have any restrictive influence, the limit on the amount of support to be financed by creditor central banks resulting indirectly from the limits imposed on the indebtedness of the others.

The maximum total credit effectively available would be equal to the total of the debtor quotas of all the central banks except one, which would have to be a creditor, plus the rallonge. If the creditor central bank were that of a large country, this maximum credit would amount to ECU 12.3 billion (ECU 5.1 billion in respect of quotas and ECU 7.2 billion in respect of rallonges).

The advocates of this formula stress that it presupposes that all claims under the short-term monetary support arrangements would have the properties of reserve assets in ECUs, particularly in terms of conditions and mobilisation.



V. SHOULD SPECIAL RULES BE APPLIED TO CERTAIN LIABILITIES/CLAIMS ARISING FROM INTERVENTIONS UNDER THE NEW EXCHANGE RATE SYSTEM?

Some members would like special financing terms to be applied to interventions made by a creditor, or in the currency of a creditor, whose currency was divergent (see Report No. 40, Section III,(a),2).

Most of the members consider it undesirable to apply a different set of rules to claims and liabilities resulting from the new intervention system.

Some experts point out that under a parity grid system, with the ECU acting as an indicator of divergence, this problem of the divergent creditor could be dealt with satisfactorily through the intervention system outlined in the combined formula. Under this formula, a central bank which is called upon to undertake intra-marginal interventions would limit such interventions to a ceiling fixed in advance. Moreover, the intervention burden of a currency which reached its bilateral limit without having crossed its divergence threshold would normally be alleviated by concurrent interventions in dollars and/or other Community currencies by the central bank of the currency at the opposite limit (see Report No. 40 of the Group).

VI. SUMMARY

A large majority of the Group agree that if the new European monetary system is to be set in motion as soon as possible, the expansion of the credit facilities required for the system to function must be based on the existing arrangements. The scale and practical details of such an expansion give rise, however, to different views which have been set out in the present report and on which the Governors are asked to take a decision. It will be necessary, in particular, to reach agreement on the following questions:

- Should the duration of initial very short-term financing be extended to sixty or ninety days from the end of the month, or should it be maintained at its present term of thirty days from the end of the month?



- Should the initial duration of short-term monetary support be extended from three to six months and should a renewal facility for the same period be retained?
- In the light of the questions raised in this report and the working hypothesis used to illustrate them, which formula may be considered most appropriate for the expansion of short-term



credit?

ALTERNATIVE FORMULAE FOR AN EXPANSION OF RECIPROCAL COMMUNITY CREDIT FACILITIES

(in millions of ECUs)

of which:	Overall amount	1)		25,000		25,000 ⁵⁾		Debtor	
		Debtor	Creditor	Debtor	Creditor	Debtor	Creditor		
- medium-term financial assistance		5,450		5,450		(5,450)		11,260	
- short-term monetary support		13,740	20,280	19,550		25,000		13,740	
SHORT-TERM MONETARY SUPPORT									
A. QUOTAS AND RALLONGES									
	%	Debtor	Creditor	Debtor	Creditor	Debtor	Creditor	Debtor	
Deutsche Bundesbank	22.02	1,440	2,880	3,303	6,606	2,750	5,500	1,440	
Bank of France	22.02	1,440	2,880	3,303	6,606	2,750	5,500	1,440	
Bank of England	22.02	1,440	2,880	3,303	6,606	2,750	5,500	1,440	
Bank of Italy	14.68	960	1,920	2,202	4,404	1,835	3,670	960	
Netherlands Bank	7.34	480	960	1,101	2,202	920	1,840	480	
National Bank of Belgium	7.34	480	960	1,101	2,202	920	1,840	480	
National Bank of Denmark	3.30	216	432	495	990	415	830	216	
Central Bank of Ireland	1.28	84	168	192	384	160	320	84	
Total quotas	100.00	6,540	13,080	15,000	30,000	12,500	25,000	6,540	
Multiplier coefficient applied to present quotas (in ECUs)		2	2	4.50	4.50	3.80	3.80	2	
Total rallonges		7,200		4,550		12,500		7,200 ²⁾	
Multiplier coefficient applied to present total of rallonges		2	2	1.27		3.47		2	
B. TOTAL CREDIT EFFECTIVELY AVAILABLE⁴⁾									
of which: Quotas		11,520		14,450		20,750		12,300 ³⁾	
Rallonges		(4,320)		(9,900)		(8,250)		(5,100)	
		(7,200)		(4,550)		(12,500)		(7,200)	

1) Normal amount taken as a starting-point.
 2) Each central bank can draw automatically on the rallonge an amount corresponding to 150 per cent. of its quota.
 3) In the event of all the central banks being debtors except that of one of the three large countries.
 4) See footnote on page 6 of the Report.
 5) It is envisaged under this formula that the total credit outstanding under the two schemes (short-term monetary support and medium-term financial assistance) would not exceed 25 billion ECU.

