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Switzerland‘s Monetary Bilateralism
The episode of 1975

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BASLER SCHRIFTEN ZUR EUROPÄISCHEN INTEGRATION

Foreword

The present article is a contribution to the history of the monetary relations between Switzerland and its European neighbours. Despite Switzerland's close economic ties with the European Community, monetary relationships have remained loose and informal. Since the breakdown of the Bretton Woods regime of fixed exchange rates, Switzerland has in general followed an autonomous policy of domestic monetary control although exchange rate considerations have required compromises at times.

Yet monetary autonomy was not the sole option that was considered by the Swiss authorities when in 1973 the Bretton Woods regime collapsed. Thirty years ago, the Swiss authorities applied for the association of the Swiss franc with the then "snake", an exchange rate mechanism between the currencies of some core European countries. This initiative, which was intended to stop the strong upward pressure on the Swiss franc exchange rate, failed. Switzerland had to cope alone with the turbulences of the international monetary environment in the 1970s which affected hardly any currency more than the Swiss franc.

Until today, the episode of 1975 has remained the sole attempt by Switzerland to follow a "bilateral" approach in the monetary field. Literature on this episode has remained scarce and the present article is intended to fill this gap. From a historical perspective, it appears interesting to look into the motives which led the Swiss authorities to launch their initiative and the reasons which accounted for the failure of the negotiations. It is also worthwhile to analyse the implications of the episode of 1975 for the subsequent developments in the relationships between Switzerland and the European Community.

This article has benefited from several comments from individuals who were involved in European monetary cooperation in the 1970s, in particular: Henning Dalgaard, former Assistant Governor of Danmarks

Nationalbank; Robert Raymond, Honorary Director General of the Banque de France and former Director General of the European Monetary Institute; Jean Jacques Rey, Honorary Director of the Banque Nationale de Belgique; and Jean Zwahlen, former Director of the Swiss National Bank. The responsibility for the content of this article, however, remains entirely mine.

Hanspeter K. Scheller

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Introduction and overview

"Bilateralism" is the term which characterises Switzerland's current approach vis-à-vis the European Union. Given its historical focus on independence and self-determination, Switzerland is opposed to full membership of the European Union. Instead, given the close economic links with its European neighbour countries, Switzerland aims at formal relationships with the European Union only in selected economic and technical areas.

"Bilateralism" started long before the term was developed. Thirty years ago in March 1975, the Swiss authorities approached the then European Economic Community (EEC)[1] with a view to establishing closer monetary and exchange rate policy cooperation. Gathered in Basle on 11 March 1975, the members of the Committee of Governors of the central banks of the Member States of the European Economic Community (hereafter referred to as the "Committee of Governors")[2] were surprised by the announcement of their then Chairman, Erik Hoffmeyer, Governor of Danmarks Nationalbank, that Fritz Leutwiler, President of the Swiss National Bank, wanted to take the opportunity of the Committee's regular March meeting on the premises of the Bank for International Settlements (BIS)[3] to make an important announcement. Fritz Leutwiler explained that the Swiss authorities had started to explore the possibility of associating the Swiss franc with the European exchange rate system, which was commonly known as the "snake". The Committee agreed to consider the matter after a technical examination to be made by its central bank experts in cooperation with the experts from the Swiss National Bank. A few months later, it became apparent that an association of the Swiss franc with the "snake" met with insurmountable political difficulties and the Swiss authorities withdrew their request.

The Swiss initiative was only a short episode in the history of its dealings with the European Community. It is however interesting because it

made apparent the limits of Switzerland's bilateral approach to the Community. Switzerland had to realise that cooperation in the field of monetary and exchange rate policy was not feasible without the prospect of political integration in the European Community.

Section 1 describes the background to the Swiss initiative to associate the Swiss franc with the then European exchange rate system in the aftermath of the fundamental changes in the international monetary environment.

Section 2 summarises the proceedings in the Committee of Governors and at the level of the Ministers of Finance about the Swiss initiative and the circumstances which eventually led the Swiss authorities to withdraw their request.

Section 3 considers the implications for the subsequent development of the relationships between Switzerland and the European Community of the failure to establish close monetary relationships between the European currencies and the Swiss franc.

1. Background

The initiative to explore a possible association with the "snake" was undertaken by the Swiss authorities at the beginning of 1975 against the background of the excessive upward pressure on the Swiss franc in an unsettled international environment in the aftermath of the breakdown of the Bretton Woods system and the first oil price shock in 1973. No currency recorded a stronger appreciation than the Swiss franc following the transition to generalised floating in 1973. The "meteoric rise" of the Swiss franc[4] over a short period of time up to the beginning of 1975 not only against the dwindling US dollar but also against the currencies of its main European trading partners, in particular Germany, caused serious problems for Swiss exports and threatened to exacerbate the economic recession in Switzerland. Prospects for greater exchange rate stability in the future were uncertain in the new international monetary environment.

1.1 The international environment

The international environment was characterised by a high degree of uncertainty which was reflected in volatile foreign exchange markets following the collapse of the Bretton Woods system of fixed exchange rates and the first oil price shock in 1973. The transition to floating had freed monetary authorities from external constraints but these external constraints manifested themselves in significant exchange rate movements between major currencies over short periods of time.

1.1.1 The collapse of the Bretton Woods system

The Bretton Woods system, which had been established in 1944 and had been based on the gold convertibility of the US dollar and fixed but adjustable parities of the member currencies vis-à-vis the American greenback,[5] had already shown increasing signs of strains towards the end of the 1960s. The US administration under President Nixon who

took office in 1969 pursued a highly expansionary fiscal policy which was accompanied by a lax monetary policy and displayed a disregard of the consequences for the US balance of payments and, given the specific role of the US dollar, for international monetary stability. This policy of "benign neglect" of US international responsibilities gave rise to huge flows of short-term capital from the United States to Europe and Japan. Their official dollar holdings increased fourfold between 1968 and 1972. The monetary effects of such action threatened to undermine domestic price stability and the continuation of dollar support met with increasing reluctance in Europe and Japan.

Against this background, turbulence on foreign exchange markets accentuated sharply in early 1971. On 9 May 1971, Germany let its currency float; in August 1971 the United States declared formally that they would no longer honour their commitment to convert US dollar balances held by foreign central banks into gold and thus removed a core element of the Bretton Woods system (see the chronology in Appendix I).

The "Smithsonian Agreement" concluded in December 1971 was the last attempt to keep alive the dwindling Bretton Woods system of fixed but adjustable parities. It included a new structure of parities involving in particular a sizeable devaluation of the US dollar and a widening of the fluctuation margins vis-à-vis the American currency to +/- 2.25%. However, the Smithsonian Agreement barely lasted a year. In January 1973, against the background of renewed turbulence on the foreign exchange markets, the Swiss authorities decided to let their currency float. Japan followed suit in February 1973 and the EEC Member States did the same in March 1973. After almost 30 years of existence, the regime of fixed parities had eventually collapsed. The new floating exchange rate regime, which was legalised in new IMF rules two years later, posed new challenges for the monetary decision-makers.

1.1.2 The first oil price shock

Another disruptive element of the international environment in the period under review was the first oil price shock in late 1973. The fourfold rise in the price of oil exerted strong inflationary pressure, causing inflation rates to rise two or threefold and unprecedented current account imbalances for most countries. The current account surplus of the oil-exporting countries rose from USD 5 billion in 1973 to USD 70 billion in 1974. The current account position of the OECD countries ended up in deficit by USD 33 billion, while that of non-oil developing countries was about USD 25 billion, as against USD 8 billion the year before.[6] At the same time, given diverging policy responses to these problems, imbalances between industrialised countries also increased. This situation, together with the diminishing role of the US dollar as a reserve currency and the corresponding shifts into alternative currencies, led to pronounced unrest on the foreign exchange markets with the result that exchange rates moved out of line with fundamentals.

1.2 Exchange rate developments of the Swiss franc in the first half of the 1970s

In 1971, still under the Bretton Woods regime of fixed exchange rates, the Swiss franc had already been revalued twice against the US dollar without escaping from further upward pressure on the exchanges until the beginning of 1973. First, on 9 May 1971, it was revalued by 7.07% and second, on 18 December 1971, by 6.4% in the context of the Smithsonian Agreement. The two realignments resulted in a revaluation of 13.9%.

By contrast and against all expectations, the transition to floating did not immediately lead to further very sharp and permanent shifts in the exchange rate structure prevailing in March 1973. The size of market exchange rate fluctuations among the major currencies including the Swiss franc increased sharply but, until September 1974, changes in

effective (trade-weighted) exchange rates remained relatively limited.

Table 1 Development of the Swiss franc's external value,

January 1973 – December 1998

(Index: January 1973 = 100)

	Sep. 1974	Mar. 1975	Dec. 1975	Sep. 1978	Dec. 1979	Dec. 1998
Spot market rate against:						
• US dollar	124.4	150.7	141.5	237.3	233.3	274.7
• Deutsche Mark	103.6	109.2	116.1	146.4	126.5	143.2
Effective exchange rate against:						
• 24 trading partners						
nominal	116.4	129.0	133.5	206.4	189.0	257.2
real (1)	112.0	121.1	119.7	150.8	130.9	140.0
• euro area (2)						
nominal	112.5	122.2	127.0	193.9	172.6	249.3
real (1)	110.0	116.8	117.1	146.6	125.1	141.6

Source: Swiss National Bank.
(1) Real effective exchange rates are based on consumer price indices.
(2) The euro area currencies are the currencies of those EU countries which form the euro area today, namely Belgium, Germany, France, Spain, Greece, Ireland, Italy, Luxembourg, the Netherlands, Austria, Portugal and Finland.

In particular, the Swiss franc mirrored relatively closely the exchange rate development of the Deutsche Mark (see Table 1).

However, as from the last quarter of 1974, the Swiss franc appreciated strongly against all other major currencies including the "snake" currencies. In effective terms, the Swiss franc appreciated by more than 10% during the six months up to March 1975. The cumulative

Table 2 Switzerland's balance of payments, 1972-78

(In millions of Swiss francs)

Year	Current account balance	Capital account balance (non-banks)	Overall balance of payments	Change in net official assets	Change in commercial banks' net position
1972	840	-925	-85	55	-140
1973	890	1,140	2,030	2,400	-370
1974	510	2,420	3,180	220	2,960
1975	6,680	4,800	11,480	3,395	8,085
1976	8,420	-1,985	6,435	6,255	180
1977	8,270	2,933	11,203	1,611	9,592
1978	7,870	7,734	15,606	10,611	4,995

Sources: BIS, Swiss National Bank.

change since the beginning of 1973 rose to almost 30% in nominal terms and to more than 20% in real terms.

A look at Switzerland's balance of payments (see Table 2) suggests that the strong appreciation of the Swiss franc in the period under review mainly resulted from private non-bank capital inflows. Whereas in previous years non-banks had been net capital exporters (offsetting Switzerland's current account surplus), the capital account swung into large and ever-rising surpluses in the period from 1973 to 1975. These inflows originated from the diversification of private portfolios out of the US dollar. Given Switzerland's economic strength and the soundness of its economic policy (at least in comparison with other major countries), the Swiss franc was one of the three currencies (together with the Deutsche Mark and the Japanese yen) which bore the brunt of this move out of the US dollar. Involuntarily, the Swiss franc thus assumed the role of "safe haven currency" but given the small size of the Swiss economy (compared with Germany and Japan) capital inflows into Switzerland had a comparatively much more decisive impact on the exchange rate than on those of the other two safe haven currencies.

The strong capital inflows added to the current account surpluses recorded in the same period which tended to rise sharply so that the

overall balance of payments of the non-bank sector swung into a huge surplus. To the extent that the central bank did not intervene on the foreign exchange markets, the overall surplus was mirrored in an increase of the commercial banks' net foreign position. However, given the uncertain prospects for the US dollar, banks were only willing to increase US dollar holdings if US dollar exchange rates were falling (and Swiss franc exchange rates rising).

In a world of growing current account imbalances (between oil-importing countries, on the one hand, and oil-exporting countries, on the other, but also among oil-importing countries), Switzerland's favourable current account performance may also have been a factor behind the appreciation of the Swiss franc in 1974 and early 1975. With current accounts reacting very slowly to exchange rate movements, currency appreciation in its turn contributed to boosting current account surpluses further in the shorter run. This so-called J-curve effect (which applied equally in the opposite direction to the relationship between exchange rate depreciation and current account deterioration) was enhanced if and when the monetary authorities did not accommodate the terms-of-trade effect of currency appreciation. This was also the case for Switzerland where the monetary authorities gave priority to the fight against rising inflationary pressure.

Given the strong sensitivity of the Swiss franc exchange rate to bouts of US dollar weakness, the Swiss currency's appreciation vis-à-vis the then "snake" currencies and the French franc went far beyond

Table 3 **Consumer prices**

(Twelve-month rates of change to year-end)

	1972	1973	1974	1975	1976	1977	1978	1979
Belgium	6.4	7.3	15.7	11.0	7.6	6.3	3.9	5.1
Denmark	7.1	12.6	15.5	4.3	13.1	12.2	7.2	11.8
Germany	6.5	7.8	5.9	5.4	3.7	3.5	2.5	5.4
France	6.9	8.5	15.2	9.6	9.9	9.0	9.7	11.8
Netherlands	7.9	8.2	10.9	9.1	8.5	5.2	3.9	4.8
Switzerland	6.9	11.9	7.6	3.4	1.3	1.1	0.7	5.1

Source: BIS.

Table 4 **Current accounts**

(In billions of US dollars)

	1972	1973	1974	1975	1976	1977	1978	1979
BLEU	+2.2	+2.5	+0.9	+1.1	-0.3	-0.3	-0.9	-3.8
Denmark	-0.1	-0.5	-0.9	-0.5	-1.9	-1.6	-1.5	-3.0
Germany	+0.8	+4.3	+9.7	+3.8	+3.9	+3.9	+8.9	-5.8
France	+0.3	-0.7	-5.9	+0.0	-5.9	-3.2	+3.7	+1.5
Netherlands	+1.3	+2.2	+2.0	+1.5	+2.7	+0.3	-1.4	-2.3
Switzerland	+0.2	+0.3	+0.2	+3.0	+3.5	+3.7	+4.4	+2.5

Source: BIS.

what was deemed reasonably compatible with the comparative development of fundamentals (see Tables 3 and 4 above). This was particularly true with regard to the exchange rate vis-à-vis the Deutsche Mark, the currency of Switzerland's most important trading partner. By March 1975, the Swiss franc had risen by almost 10% since January 1973. With inflation running at a faster pace in Switzerland, however, the real appreciation, based on purchasing power parities, was some 15%. Furthermore, the respective current account positions of the "snake" countries and Switzerland did not justify such an appreciation of the Swiss franc vis-à-vis the "snake" currencies.

In particular because of the real appreciation vis-à-vis the "snake" currencies, Switzerland was showing signs of loosing ground competitively.[7] This was especially reflected in the decline of Swiss exports in volume terms. While the resulting deterioration of Switzerland's trade balance was more than offset by the improvement in other current account items, it contributed significantly to the move of the Swiss economy into recession. Furthermore, as was confirmed in the subsequent US dollar crises (see Section 3.1 below), fresh bouts of weakness of the US dollar were expected to push up the Swiss franc again, more strongly than other safe haven currencies and in particular the Deutsche Mark. Given the similarities between Germany and Switzerland with regard to inflation performance and economic policy, the exchange rate vis-à-vis the Deutsche Mark was the main criterion for the Swiss franc exchange rate performance.

1.3 Measures against the appreciation of the Swiss franc

Switzerland reacted to the strong appreciation of the Swiss franc by intervening on the foreign exchange markets and by tightening foreign exchange control.

1.3.1 Intervention

The Swiss National Bank resumed intervention on the foreign exchange in January 1975 after a long pause of almost two years since February 1973. The aim of the intervention was to convey to the markets the Swiss central bank's exchange rate policy intention and to preserve orderly market conditions. However, in the light of past experience, the Swiss National Bank was aware of the fact that even massive intervention would not be able to stop the rise of the Swiss franc in the face of market forces. Such an undertaking was doomed to fail, given the disproportionate relations between the worldwide US dollar volume and the means of intervention of a small currency.[8]

In 1975, the US dollar purchases by the Swiss National Bank totalled the equivalent of CHF 11 billion. However, CHF 9 billion was drained over the same period by the obligation of non-residents to exchange the proceeds of Swiss franc borrowing against the US dollar at the Swiss National Bank.[9]

1.3.2 Exchange control

As regards exchange control, restrictions on short-term inflows of funds (in force since 1971) had been removed in the course of 1974 following the first oil price shock in late 1973. When this move was swiftly followed by a movement into the Swiss franc, restrictions on inflows were re-imposed on a more comprehensive scale than earlier and progressively tightened.

The measures taken by the Swiss authorities in the period under review (see Appendix II) mainly consisted of imposing negative remuneration of Swiss franc deposits held by non-residents with Swiss banks and of regulating Swiss banks' foreign exchange positions. All in all, they proved little effective in the fight against speculative capital inflows.[10] While compliance with the regulations by Swiss banks could be ensured, this was not necessarily the case for the non-bank sector. Furthermore, since the control measures applied to transactions with non-residents only, they could be circumvented by forward sales of Swiss francs to residents. However, the Swiss authorities hesitated to extend restrictions to residents. Likewise, the Swiss National Bank never made use of the authorisation to block the Swiss francs created by intervention in the foreign exchange markets. Application of this measure carried the risk of provoking quotation in a parallel market and thus would have run counter to the intentions of the Swiss authorities to avoid a dual exchange market.

2. Switzerland's negotiations with the "snake" countries

Following the breakdown of the Bretton Woods system of fixed exchange rates, a formal exchange rate link with the currencies of Switzerland's main trading partners appeared to be the best solution to the Swiss authorities.

2.1 What was expected from an association of the Swiss franc with the "snake"?

As was clearly pointed out by the President of the Swiss National Bank, Fritz Leutwiler, in his speech to the General Assembly of the Swiss National Bank in April 1975, the Swiss authorities were among those policy-makers of the time who considered that the transition to floating had not been a deliberate choice of a better exchange rate system. In their opinion, the great majority of governments and central banks had not opted for the system of floating exchange rates; in abandoning fixed rates they had been bowing to the force of circumstances.

In 1975, President Leutwiler's assessment of the new foreign exchange regime was rather negative. He stated that the most telling argument in favour of floating – the independence of national monetary policy from external influences – had only limited validity. While floating gave the authorities better control over the domestic money supply, the inflow of funds from abroad could not be stopped. The dependence on other countries was no longer directly reflected in the development of the money supply, but in exchanges rates. This would adversely affect a country's competitive position to such an extent that in the end an adjustment of that country's own monetary policy became unavoidable.

Leutwiler recognised that prerequisites for the restoration of a system of fixed exchange rates were not fulfilled, given the differences between the leading countries in terms of economic development. However, he insisted that small steps should be possible and the question of Switzerland's participation in the "snake" was to be seen in the light of at least a partial return to more stable exchange rates.

The Swiss authorities expected the formal association of the Swiss franc with the "snake" to moderate expectations of a further appreciation of their currency. The formal link to the "snake" would in particular help to avoid the Swiss franc moving away from the Deutsche Mark in case of shock waves from the US dollar. It would also represent a contribution of Switzerland to the long term objective of re-establishing stable exchange rates in a new international monetary order.[11] It would also avoid the need for a further tightening of exchange controls; such a tightening would increase bureaucracy and was expected to impact unfavourably on foreign trade. It would also meet with the strong opposition of Swiss banks which were opposed to any further restrictions on their activities.[12]

The timing of the initiative also appeared adequate. In March 1973, the Swiss authorities had declined the invitation by the "snake" countries to participate in the joint float.[13] The decision was not motivated by fundamental objections; instead, the Swiss franc was deemed to be undervalued vis-à-vis the "snake" currencies at that time. With the recent sizeable appreciation of the Swiss franc its undervaluation vis-à-vis the "snake" currencies was now completely reversed. Thus, the right moment for closer monetary and exchange rate cooperation had come.

The views held by the Swiss National Bank were shared by the Swiss Government, which had authorised the central bank to start the dialogue with the Committee of Governors. The ruling political parties[14] and the representatives of the Swiss economy[15] generally welcomed the initiative of the Swiss authorities. Furthermore, the association would not imply political risks since it did not require a legislative act which was subject to any referendum by the "Swiss sovereign", i.e. the people and cantons of Switzerland.

Given its stability-oriented monetary and economic policy, Switzerland

expected to be received with open arms by its prospective partners, which were all committed to the objective of price stability (albeit experiencing varying degrees of success in the actual realisation of this objective). The enlargement of the "snake" would be a further step towards restoring exchange rate stability at least on a regional basis. Under the prevailing circumstances, this latter aim (and not the move towards a monetary union) appeared to be the ultimate raison d'être of the "snake". However, in the course of the negotiations, the Swiss authorities had to recognise that they had erred on the character of the "snake" mechanism.

2.2 The "snake" in 1975

The exchange rate system with which the Swiss authorities wanted to associate the Swiss franc was officially called "the Community mechanism for the progressive narrowing of the margins of fluctuation between the currencies of the Member States of the EEC". The mechanism, which soon became known as the "snake", was put into operation in April 1972 as one of the elements of the first phase of the move towards an economic and monetary union between the EEC Member States (see Appendix III). According to the "Werner Plan" adopted by the Heads of State or Government in 1971, the economic and monetary union was to be realised by 1980.[16]

However, at the beginning of 1975, the "snake" looked more like a narrow regional exchange rate mechanism than a Community mechanism heralding a forthcoming economic and monetary union. At the beginning of 1975, out of the then nine EEC Member States, only five (Germany, Denmark and the three Benelux countries[17]) participated in the "snake". The United Kingdom and Ireland had withdrawn their currencies[18] from the mechanism in summer 1972 soon after the inauguration of the "snake"; Italy had done the same in February 1973 and France had suspended intervention obligations in January 1974. The first oil price shock in late 1973 had led to divergent economic policy responses by EEC Member States with disintegrating effects and this left little hope that the objective of economic and monetary union could be realised. The first phase of the move towards economic and monetary union had come to an end in 1973 without the EEC Member States deciding on the entry into the second phase.

The "hybrid" character of the "snake" was reinforced by two elements. First, despite its Community mission, the "snake" was not established by Community law as the EEC Treaty lacked a monetary capacity at that time. Instead, it was based on a Resolution of the Council of Ministers and of the representatives of the EEC Member States[19] and the Agreement between the EEC central banks fixing the operating modalities of the mechanism ("Accord de Bâle")[20]. Membership in the "snake" was voluntary and each member of the "snake" was able to adjust the central bilateral rates of its currency vis-à-vis its partners' currencies without much discussion, not to speak of consent, with the other "snake" members. Except for the intervention obligation to defend the currency at the margins, "snake" membership did not imply obligations to adjust monetary and economic policies in case of tensions within the mechanism.[21]

Second, the "snake" also comprised two non-EEC currencies, i.e. the Norwegian kroner and the Swedish krona. Norway had been an accession country in 1972 and thus had participated in the "snake" arrangement, like the other three accession countries (Denmark, Ireland and the United Kingdom). When Norway did not ratify the Accession Treaty with the EEC following the negative outcome of the referendum in Norway in September 1972, the Norwegian kroner remained in the "snake" as an associated member. In contrast to Norway, Sweden had applied for association with the "snake" without any prospect of EEC membership in May 1972. The association eventually came about in March 1973; with the collapse of the Bretton Woods system, association with the "snake" was intended to ensure

stable exchange rate relationships with its Scandinavian neighbours Denmark and Norway, which were both members of the “snake”.

The exchange rate mechanism of the “snake” took the form of a parity grid between all participating member countries but actually the Deutsche Mark was the anchor of the system. This role resulted from the size and the strength of Germany’s economy and its achievements in preserving external and internal stability of its currency. Germany’s then “snake” partners were all small open economies. Although their economic performances were relatively close to each other, bilateral parities were frequently adjusted with a view to offsetting differences in fundamentals and restoring stability in the mechanism.

2.3 The dialogue with the Committee of Governors and the Ministers of Finance

The negotiation between the Swiss authorities and the “snake” countries mainly took the form of a dialogue between the Swiss National Bank and the central banks gathered in the Committee of Governors. Given the nature of the “snake” as a mechanism based on the cooperation between the member central banks, the Committee of Governors was the forum for discussing all matters relating to the operation of the “snake”, irrespective of the fact that in 1975 only half of the EC Member States participated in the exchange rate mechanism. In addition, the Committee of Governors gave advice to the ultimate decision-makers, i.e. the Ministers of Finance and the central bank Governors of the “snake” member countries (see Appendix III).

The Committee of Governors met with Mr. Leutwiler in March, April and May. The meetings in April and May also involved the central bank Governors of the two associated “snake” members. In addition, representatives of the Swiss National Bank met several times with the foreign exchange experts of the Committee of Governors and participated in the drafting of the reports from the experts to their parent committee.

The second forum was the Ministers of Finance and the central bank Governors of the “snake” member countries. They decided by common accord on the shape and membership of the “snake” and thus were also involved in the Swiss issue which was discussed frequently between March and September 1975. The group which was presided over by the Belgian Minister of Finance, Willy de Clerk, in 1975 was regularly informed by the Committee of Governors about the state of the discussions both by written reports from the Committee of Governors and by oral reports from the Chairman of the Committee of Governors. Direct contact with the Swiss authorities, however, were limited to a meeting on 22 September 1975.

The third forum was the Council of the European Communities in the composition of the Ministers of Finance and Economy of the EEC Member States (called the “ECOFIN Council”). Given the nature of the “snake” as a Community mechanism, the ECOFIN Council claimed the right to take the ultimate decisions with respect to the “snake”; actually, its role was limited to taking note of, and endorsing, the decisions taken by the Ministers of Finance and central bank Governors of the “snake” member countries. The Swiss question was dealt with twice in an official Council session, namely on 10 July and 22 September 1975.[22] In other instances, it was probably discussed at the Finance Ministers’ luncheons on the occasion of Council sessions. Such discussions were only recorded in Council documents if and when they led to decisions to be taken by the ECOFIN Council in official session.

At the meeting of the Committee of Governors on 11 March 1975, President Leutwiler submitted the Swiss case by emphasising that it was not yet a formal request to join the “snake” and that it did not mean joining the EEC. The immediate reaction to Leutwiler’s exposé was not unfriendly although, in the absence of prior consultation with their respective governments, most Governors’ reaction was non-committal. The then Governor of the Banque de France, Bernard

Clappier, however, emphasised the Community dimension of the "snake" and wondered whether the association of a third-country currency like the Swiss franc was necessarily compatible with this dimension.

Following the first round of discussion, the Committee agreed to mandate its Alternates[23] and its foreign exchange experts[24] to prepare the Committee's discussion. The study of the experts was to be carried out in cooperation with the experts from the Swiss National Bank. However, all reports from the experts reflected the views of the EEC member central banks and not necessarily those of the Swiss National Bank.

When at the Committee's April meeting divergent views arose among the Governors about the usefulness of supporting the Swiss request, the experts were requested to present further studies for the next meeting of the Committee in May. However, the new reports from the Governors' Alternates and experts did not shed much more light on the issue under consideration, in particular as regards the origin of the capital inflows into Switzerland and the likely impact of an association of the Swiss franc on the functioning of the "snake" and its ability to re-integrate the EEC currencies that had previously left it. The statistical data which the Swiss National bank was able to present were deemed to be insufficient to clarify the first question, while the second question could hardly be clarified by technical studies. Given the sensitivity of foreign exchange issues, there was some reluctance to put every possible scenario on paper.

On 9 May 1975, before the Committee was compelled to take a final position, the French President announced the return of the French franc to the "snake" under conditions still to be agreed among the "snake" countries. Accordingly, the Committee of Governors stopped its discussion on the Swiss request and gave priority to the elaboration of the arrangements under which the French franc was to rejoin the "snake". The Swiss National Bank politely expressed its

comprehension of this postponement.

After the amendments to the "snake" rules and the subsequent re-integration of the French franc in the "snake" in July 1975, the Community fora resumed the discussion on the Swiss case. Meeting on 10 July 1975 in Brussels, the Ministers of Finance and the central bank Governors of the "snake" countries (now including France) expressed their desire to continue the discussions with the Swiss authorities and invited a Swiss delegation to meet them on 22 September 1975. The ECOFIN Council, meeting on the same day, noted "that contacts with Switzerland would continue, it being understood that the final decision on the matter would rest with the Council."[25]

At the meeting of the Ministers of Finance and the central bank Governors of the "snake" countries with the Swiss delegation headed by the Minister of Finance, Federal Counsellor Chevallaz, and the President of the Swiss National Bank on 22 September 1975, France held up its opposition to the association of the Swiss franc with the "snake" and made it subject to the development of certain rules with regard to fiscal and customs convergence. However, the French Minister of Finance, Jean-Pierre Fourcade, eventually accepted the proposal made by the Chairman to distinguish between the technical issues (to be resolved prior to the association of the Swiss franc with the "snake") and other issues of common interest (to be addressed after the entry into the "snake").[26] Accordingly, the Ministers of Finance released to the press that, "in principle", they were unanimously in favour of the association of the Swiss franc with the "snake", subject to the clarification of certain technical issues. On the same day, the Council of Ministers took note of this meeting and agreed to continue its examination of the Swiss case at its November session.[27] The Committee of Governors was urged to examine the pending case.

The ball was thus back in the camp of the Committee of Governors which submitted its final opinion to the Ministers on 14 October 1975. It revealed split views between "a Governor" and the other Committee

members. Whereas the latter considered that, subject to certain conditions, the association of the Swiss franc with the “snake” should contribute to greater exchange rate stability in Europe, the dissenting Governor, i.e. the Governor of the Banque de France, reintroduced the reservation against the association of the Swiss currency. In his conviction, this step would be a constant threat to the functioning of the “snake” and made any conclusion of the association agreement dependent on prior measures to be taken by Switzerland.

The divergent opinions among the central bank Governors of the “snake” countries buried any hope for a political consensus about the association of the Swiss franc with the “snake”. At the same time, the outcome of the Summit of Rambouillet[28] held from 15 to 17 November 1975 nurtured expectations of greater exchange rate stability in a wider context. Indeed, the participants agreed on regular consultations between their central banks and Ministers of Finance about interventions necessary to prevent erratic exchange rate fluctuations. Although the notion of “erratic exchange rate fluctuations” always remained controversial the result of the Summit gave rise to hopes in Switzerland that the forthcoming concerted intervention may perhaps make the association with the “snake” superfluous.[29]

Against this background, on 19 November 1975, the Swiss authorities decided to put the topic off temporarily.[30] The withdrawal by the Swiss authorities saved the “snake” member countries the necessity to say officially no to the Swiss request. Instead, on 15 December 1975, their Ministers of Finance and central bank Governors took note of the lack of unanimity among themselves and decided to put their deliberations on the topic off temporarily.

In its turn, in October 1975, the Committee of Governors had already invited the Swiss National Bank to participate in the “concertation system”, a system for exchanging privileged information among EEC and other major central banks on exchange market developments and official action. This invitation, which was reiterated in December

1975, sounded a conciliatory note at the end of the negotiations and allowed the Swiss authorities to speak of a partial success in their endeavours for better central bank cooperation in exchange market management.

2.4 Positions taken by Community member countries

Whereas the discussions in the Committee of Governors have been well documented, there is no written evidence of the positions taken by the governments of the countries concerned. The deliberations of the Ministers of Finance and central bank Governors of the “snake” member countries were “off the record”; information is only available from those who attended the meetings.[31] The discussions conducted in the ECOFIN Council were rare and only retained in summaries. Nevertheless, even if central bank Governors sometimes developed independent views, it is assumed that their views generally coincided with those of their respective governments. In particular at that time central bank independence was not as widespread as today by virtue of the EC Treaty, so political considerations generally impacted on the positions held by the central bank Governors in the discussions of the Committee.

Germany was the country which was most favourable to the association of the Swiss franc. With Switzerland being one of Germany’s most important trading partners, more stable exchange rate relationships between the two currencies concerned were also in the interest of the export-oriented German economy. As Karl Klasen, the then President of the Bundesbank, put it, the extension of the “snake” to the Swiss franc would be a fortunate reversal of the trend towards a diminishing zone of stable exchange rates. At the same time, the inclusion of the Swiss currency was not perceived by the Deutsche Bundesbank as a major external constraint that would impact on its ability to conduct a monetary policy conducive to price stability. Germany and Switzerland shared common values

with regard to economic and monetary policy. The Swiss franc was a strong currency. The risk that the Bundesbank would be compelled by the "snake" rules to intervene in support of the Swiss franc was very low. Instead, the risk of having to support the other currencies of the mechanism was borne by the Swiss National Bank. Unlike some other EC countries (inside and outside the "snake"), Switzerland did not question the role of the Deutsche Mark as the stability anchor of the joint float. Under these conditions, the association of a strong currency like the Swiss franc was likely to enhance the nature of the "snake" as a "hard currency block".

Most of the other "snake" members at that time (including the two associated central banks, Norges Bank and Sveriges Riksbank) basically agreed with the position held by the Bundesbank. An extension of the "snake" was generally deemed to enhance exchange rate stability and thus the advantage presented by membership of the mechanism. There was also the view that it was precisely the strength of the Swiss franc and its status as a "safe haven" currency which advocated the strengthening of monetary and exchange rate cooperation with Switzerland. Since measures taken by the Swiss authorities might affect the "snake" currencies, it was better to have Switzerland in the "snake" rather than out of it. The framework for mutual exchange of information and views would allow Switzerland's "snake" partners to be informed ex ante of all Swiss policy intentions and to comment on them. Conversely, with Switzerland remaining outside the "snake" there was the risk of being surprised by measures which the Swiss authorities might take to stem the rise of the Swiss franc. Danmarks Nationalbank's then Governor, Erik Hoffmeyer, Chairman of the Committee of Governors in 1975[32], presided over the meetings with a view to reaching consensus among the interested parties.

A more sceptical note only came from the Banque Nationale de Belgique, which emphasised the risks inherent in the association of a currency like the Swiss franc. The Belgian representatives thus insisted on further studies before taking a final decision. Finally, the Belgian central bank aligned its position with that of the other "snake" members and voted in favour of the association.

From the beginning of the discussions, the Banque de France had left little doubt that it considered the envisaged association of the Swiss franc to be incompatible with France's vision of monetary cooperation in the Community. France had initially been opposed to floating as such and specifically to floating jointly with a strong currency like the Deutsche Mark when the idea had been first tabled by Germany in 1971. It had finally accepted the joint float with the Deutsche Mark (and without the Italian lira and the pound sterling) in March 1973 in the absence of any meaningful alternative. The inclusion in the joint float of a strong (non-EEC) currency like the Swiss franc was deemed to have several undesirable implications. First, given the involuntary role of the Swiss franc (together with the Deutsche Mark) as a "safe haven" currency, it was expected to create tensions in the "snake" by transmitting shocks to the exchange rate mechanism whenever there was a further move out of the US dollar. This would be detrimental for the currencies which did not yet benefit from the same credibility as the Deutsche Mark and which would therefore bear the brunt of the risks associated with the inclusion of the Swiss franc in the "snake". Second, the envisaged association was expected to put greater emphasis on the nature of the "snake" as a "Deutsche Mark zone" instead of an element in the move to economic and monetary union. In 1975, France still demonstrated its commitment to this goal but its approach to the realisation of this goal was not shared by Germany, which insisted on economic convergence as a precondition for an economic and monetary union. A reconciliation of these divergent positions was not yet within reach in 1975. It was eventually possible a few years later with the creation of the EMS in 1979 and subsequently with the adoption by France of its policy of the "franc fort" in 1983.

However, not being a member of the “snake” since January 1974, France was not in the circle of the countries that would eventually decide on the Swiss request. Indeed, the French Government had decided to let the franc float as from 21 January 1974 for a period of six months but when the time limit had expired the French franc did not return to the “snake”. Instead, the French authorities made the return of the franc dependent on certain changes to the system as proposed in the “Plan Fourcade”[33]. The proposals comprised: (i) a target zone for the US dollar to be defended by joint intervention; (ii) a more equitable distribution of intervention obligations between strong and weak currency countries; and (iii) a change to the financing and settlement rules in the “snake”.

None of the three conditions were fulfilled in spring 1975. The establishment of a target zone for the US dollar met with the opposition of the Deutsche Bundesbank and the US authorities showed little willingness to cooperate. Instead, the arrangement agreed upon in January 1975 only provided for some vague rules aiming at limiting daily fluctuations of exchange rates vis-à-vis the US dollar. A more equitable distribution of intervention obligations between strong and weak currency countries – whatever this meant in a grid of bilateral central and intervention rates[34] – was not acceptable to the Deutsche Bundesbank which was not prepared to give up its (just regained) autonomy in monetary policy for new Community constraints. The third issue had not even been addressed yet in the Committee of Governors.

Nevertheless, on 9 May 1975, the French President announced the return of the franc to the “snake”. Officially, the French decision was motivated by the strong performance of the French franc (which actually had regained its exchange rate level before it left in January 1974) and France’s commitment to the goal of economic and monetary union. The 9 May was chosen as the date of announcement as it was the Community holiday commemorating Robert Schuman, one of the founding fathers of the Community. However, everybody understood that the return of the French franc to the “snake” was meant to provide France with more leverage in the decision-making on the Swiss case.

The other central banks outside the “snake” did not take an active part in the discussion on the Swiss case. They had withdrawn their currencies from the mechanism already in June 1972 (the United Kingdom and Ireland) and February 1973 (Italy), and did not consider any return in the foreseeable future. The Governor of the Bank of England emphasised that the association of the Swiss franc would exclude a return of the pound sterling to the “snake”.[35] By contrast, the Banca d’Italia expressed the hope to find the Swiss franc in the “snake” once it was able to re-integrate the lira into the mechanism.

2.5 Controversial issues

From the outset of the negotiation, it was clear that the Swiss case was somewhat different from that of Norway and Sweden. This was less obvious with regard to the technicalities of a possible association, which did not pose major difficulties. Controversial issues arose when discussions touched upon the sustainability of a possible association of the Swiss franc and its implications for the “snake”.

As regards the technicalities, the discussions concluded rapidly on giving Switzerland a similar status as was held by Norway and Sweden. The margin of fluctuation of the Swiss franc vis-à-vis the other “snake” currencies would be +/- 2.25%. The level of the initial central rate gave rise to some discussion since some central banks wished to place the Swiss franc in the lower part of the band with a view to avoiding an early emergence of tensions in the exchange rate mechanism. Eventually, however, it was agreed to fix the initial central rate so as to place the Swiss currency in the middle of the band upon its entry into the exchange rate system. Changes in central rates (as well as all other measures of monetary and exchange rate

policy) were subject to prior consultation with Switzerland's partners. Intervention in the partners' currencies would be compulsory at the margins and the financing of such intervention would be unlimited in amount. The initial maturity of the financing operations would be the end of the month following that of the intervention but could be extended by mutual agreement between the debtor and the creditor. Both the creditor and the debtor would benefit with regard to their bilateral balances from the same exchange guarantee as that provided by the EMUA[36] to EEC "snake" members. The settlement of bilateral balances would be in US dollars.

Controversies among EC countries and between them and Switzerland centred around the reasons for the Swiss franc's underlying strength and the likely impact on the cohesion in the "snake" of a possible association of the Swiss currency. The upward pressure on the Swiss franc was deemed to partly relate to the improvement of the current account of the balance of payments but in the absence of more precise statistical evidence a greater role was attributed to the inflows of short-term capital. In this context, it was recognised that the Swiss authorities had taken extensive measures against the inflow of capital to Switzerland. However, it was also remarked that the restrictions affected capital imports by non-Swiss residents but did not apply to forward sales of Swiss francs to residents so that the restrictions on capital inflows could easily be circumvented. Although some EEC central banks considered that there was still room for a further tightening of foreign exchange control measures, the general assessment was that any additional strengthening of the regulations could not hope to put an end to the movements of funds affecting the Swiss franc. Instead, these movements were seen in large measure as part of the financial importance of the Swiss franc. This view was also shared by the Swiss National Bank, which was against an extension of foreign exchange control measures, in particular applying to transactions by Swiss residents.

However, if foreign exchange control measures were deemed to have only limited effects on the demand for Swiss francs on the exchanges, this gave rise to the question of how cohesion in the "snake" could be preserved if and when the Swiss franc continued its upward trend. To dissipate such concerns, the Swiss National Bank made several concessions. Among other things, it:

- was prepared to give favourable consideration to requests from its partners to extend the maturity of financing operations;
- agreed to intervene in US dollars if such action was better suited than intervention in partner currencies to remedy exssive tension in the "snake" and did not impact unfavourably on the position of the "snake" vis-à-vis the US dollar;
- more generally undertook to consult with its "snake" partners to coordinate its exchange rate policy with that of its partners and, in the event of particularly strong pressure arising, to consider any measures to remedy the situation.

Most of the EEC central banks concerned deemed the commitment of the Swiss authorities to be a sufficient basis for the association of the Swiss franc with the "snake". In their view, this step would contribute to greater exchange rate stability in Europe. By contrast, the Banque de France considered that appropriate measures should be taken by the Swiss authorities prior to the signing of the association agreements and not only in the event that the strength of the Swiss currency caused tensions in the exchange rate mechanism.

The nature of the prior "appropriate measures" that were requested by France as a precondition for the entry into the "snake" remains unclear. According to official documents, the Governor of the Banque de France requested a further tightening of Swiss exchange control measures, in particular the extension of such measures to foreign

exchange transactions by residents. By contrast, in 1982, the Swiss National Bank wrote that the discussions were interrupted at the end of 1975 because France was opposed to the association or requested conditions "without relationship with exchange rate policy"[37]. This does not necessarily support the hypothesis that the envisaged association failed because of Switzerland's reluctance to impose additional foreign exchange control measures. Indeed, although the Swiss authorities were reluctant to further strengthen the regime, they considered it as a legitimate tool of their exchange rate policy.

By contrast, a condition "without relationship with the Swiss exchange rate policy" might have been the abolition or relaxation of bank secrecy. Indeed, the system of numbered accounts works irrespective of the chosen currency and was a matter of concern for many EEC Member States. Was bank secrecy actually at stake? During the discussions in the Committee of Governors, the French Governor put much emphasis on the attractive conditions for foreign financial investments in Switzerland as a cause for the underlying strength of the Swiss franc. Likewise, the French authorities raised the issue of fiscal fraud in bilateral talks which took place during the negotiations in 1975.[38]

In June 1975, the Swiss National Bank started talks with the country's leading commercial banks and proposed to abolish the system of numbered bank accounts.[39] The Swiss National Bank did not refer explicitly to the ongoing discussions about the association of the Swiss franc with the "snake". Instead, it reasoned that the system of numbered accounts was not favourable to the reputation of Switzerland and that foreign countries had expressed their dissatisfaction with the abuse of Swiss bank secrecy for the purpose of tax evasion and circumvention of foreign exchange control. Nevertheless, the timing of coincidence between the Swiss National Bank's initiative and the discussions in the Community fora on the association of the Swiss franc with the "snake" may be indicative.

The Swiss National Bank's proposal met with the determined opposition of the Swiss banks and was not followed up.[40] If France (which was quoted by the Swiss National Bank as one of the foreign countries which had expressed its dissatisfaction) requested the abolition of the system of numbered accounts as a precondition for the association of the Swiss franc with the "snake", it touched upon a major political item and could be assured that its request could never be accepted by Switzerland. At the same time, despite all the divergent views that existed at that time between Germany and France in the monetary and economic policy field, it was unlikely that Germany would enter into an open confrontation with France about the wish of a non-EEC country to participate in European monetary cooperation. Confronted with the French opposition to this initiative, Germany gave priority to the cohesion of the European Community and thus to its future development.

3. Follow-up

In 1975, the Swiss franc had only completed part of its "meteoric rise". The greater part was realised in the subsequent three years until September 1978 when the Swiss franc reached an exchange rate level that was almost the double of that prevailing after the Smithsonian realignment in 1971. The underlying strength of the Swiss franc in the period 1973-78 gives rise to the question whether an association with the "snake" would have been sustainable at all.

3.1 Exchange rate developments after 1975

When the negotiations on a bilateral association with the "snake" were suspended the Swiss authorities did not consider the alternative of a unilateral link of the Swiss franc with the joint float. Such a unilateral peg existed for the Austrian shilling since 1973 and had proved to be successful. Apparently, in the opinion of the Swiss National Bank, the adoption of the "Austrian solution" was not deemed to be a viable alternative to a bilateral association with the "snake" since it did not sufficiently comply with the aim of Switzerland contributing to the reestablishment of stable exchange rates.

Instead, the Swiss National Bank continued its monetary policy focusing on the control of the money supply in the medium run with a view to further reducing inflation rates (notwithstanding the fact that inflation was rapidly declining and had already come down to little more than 3% by the end of 1975). Accordingly, together with diminishing effectiveness of exchange controls, the Swiss franc was bound to appreciate further in an international environment which remained characterised by great uncertainty and frequent bouts of weakness of the US dollar.

The Swiss franc recorded its record high vis-à-vis the Deutsche Mark on 26 September 1978 when the German currency was quoted at CHF 0.75, down by more than 25% since the beginning of 1975. During the same period, the US dollar depreciated by some 40% to CHF 1.45. Under these circumstances, the Swiss authorities declared their intention to stabilise the Swiss franc/Deutsche Mark relationship clearly above CHF 0.80 and intervened massively in support of the German currency albeit exclusively by purchasing US dollars. Direct purchases of the Deutsche Mark would have been more efficient but were not a possibility for Switzerland as a non-member of the "snake".[41]

The strong reaction by the Swiss authorities helped to stabilise the Swiss franc/Deutsche Mark relationship. In the subsequent years and despite a further US dollar crisis in 1987, the Deutsche Mark exchange rate fluctuated within a range of CHF 0.80 to 0.90. When the Deutsche Mark was replaced by the euro in 1999, the average level of the euro vis-à-vis the Swiss franc over the last six years (CHF 1.50) corresponded roughly to a Deutsche Mark exchange rate of CHF 0.75.

All in all, over the seven years from the beginning of 1973, the Swiss franc appreciated by almost 90% against the currencies of Switzerland's 24 most important trading partners (see Table 1 above). In real terms (measured on the basis of consumer prices), the appreciation was some 30%. Against the Deutsche Mark, the Swiss franc rose by more than 25% both in nominal and real terms, with consumer price inflation running at a similar pace in Germany and Switzerland. Likewise, the real appreciation vis-à-vis the currencies of the countries which today form the euro area was of the same order of magnitude.

The rise of the external value of the Swiss franc eventually had a dampening effect on import prices but this effect was only partly passed on to domestic producer prices and consumer prices. While Swiss import prices rose on average by less than 4% p.a. from 1972 to 1978, the average rate of increase was 5% p.a. for producer prices and 7% p.a. for consumer prices. This phenomenon may be explained by particularly pronounced nominal rigidities in the Swiss economy,

weak competition in the (sheltered) domestic sector and regulatory practices which ban foreign competitors from certain domestic market segments.

The real appreciation recorded by the Swiss franc during the 1970s has never been reversed significantly in the last 25 years. Relatively moderate exchange rate fluctuations vis-à-vis the Deutsche Mark (and as from 1999 vis-à-vis the euro) and similar consumer price developments both in Germany and Switzerland account for the significant gap which exists between the nominal exchange rate of the Swiss franc and its purchasing power parity.[42]

Table 5 Gross domestic product at constant prices

(Average annual percentage changes)

	1970-1979	1980-1989	1990-1998	1999-2004
Euro area	n.a.	2.5	2.0	1.7
Germany	3.2	2.4	1.9	1.3
Switzerland	1.7	2.3	0.4	1.3

Source: IMF World Economic Outlook.

Likewise, the real appreciation of the Swiss franc is deemed to have been a major factor behind the weakening growth performance of the Swiss economy in the 1970s. In the period from 1975 to 1976, Switzerland moved into a deep and prolonged recession with a record fall of real output by more than 7%. This recession was much deeper in Switzerland than in its European neighbour countries. Switzerland also recovered from this recession much more slowly. In comparison with Germany, the rate of economic growth was almost halved in the 1970s. This gap was never closed in the 1980s and 1990s (see Table 4 below). Instead, Switzerland's economic growth performance has, on average, almost persistently remained below that of Germany. At the same time, its balance of payments' current account has recorded persistent and significant surpluses which have originated in particular from ever-rising earnings on Swiss investments abroad.

The consequences of the Swiss franc's overvaluation for the Swiss economy have thus been significant and there is the question of whether the association of the Swiss franc with the "snake" would have permitted the much desired containment of the upward trend in the Swiss franc exchange rate. This question is dealt with in the section below.

3.2 Would an association of the Swiss franc with the "snake" have been sustainable?

The history of the "snake" has shown that prevailing exchange rate structures never withstood strong underlying market pressure unless the authorities reacted to tensions in the system by adjusting their respective monetary and economic policy. If the authorities were unable or unwilling to ensure the credibility of the prevailing parity grid, speculation against a currency mounted and became risk less for the speculators. The stronger the speculation and thus the higher the volume of intervention necessary to defend the parity, the sooner the authorities would yield to market pressure and decide on a new realignment.

While Germany set the monetary stance for the "snake" by pursuing its stability-oriented policy, Germany's partners had to bring their policies to line with the monetary stance of the system. Policies geared to defending the exchange rate link with a strong currency thus also ensured domestic stability for Germany's partners. Where and when this target proved to be too ambitious, parities were realigned. The latter was rather frequent in the history of the "snake" so that the system was sometimes called a "crawling peg".[43]

Central bank policy has a lot to do with psychology and thus it is impossible to exclude ex post the hypothesis that a formal association of the Swiss franc with the "snake" could have had a stabilising impact on exchange rate expectations. The similarity of fundamentals in both Germany and Switzerland, in particular the development of inflation

and current account positions, would have been supportive to the credibility of the Swiss franc/Deutsche Mark parity in the “snake”. Furthermore, membership in the “snake” would have enriched the arsenal of tools which would have been available to the Swiss National Bank for the defence of the Swiss franc exchange rate, in particular direct intervention in the partners’ currencies.

However, the Swiss franc’s role (shared with the Deutsche Mark) as an alternative reserve currency to the US dollar would have been expected to complicate the functioning of the exchange rate mechanism. First, it might have reinforced the shock waves which the frequent dollar crises transmitted to the “snake”. Second, although both the Deutsche Mark and the Swiss franc would have been expected to appreciate simultaneously when the US dollar weakened, the upward pressure on the Swiss franc might have been stronger than that on the Deutsche Mark. Under these circumstances, the sole declaration of a link with the Deutsche Mark and the more effective intervention facilities offered by the “snake” mechanism to its members would not have been sufficient to stop the underlying upward trend of the Swiss franc exchange rate. It would have been very likely that Switzerland would have been confronted with two options if it wanted to maintain its association with the “snake”.

The first option would have been to revalue frequently the Swiss franc whenever there had been strong upward pressure on it. However, frequent revaluations without adjustment of domestic policies might have brought the Swiss franc to an exchange rate level against the Deutsche Mark which would not have been very different from the actual level reached in 1978. The adjustment of the Swiss franc’s central rate in several steps might have even overshot this level if and when the authorities of the “snake” member countries had tried to ensure the cohesion in the “snake” by realigning central rates in a significant manner.

The second option would have been for Switzerland to adjust its monetary policy in response to the tensions which might have developed in the “snake” following a formal association of the Swiss franc. The adjustment would have meant giving up monetary control by satisfying the demand for Swiss francs. The aforementioned episode of 1978 proved that the declaration of an exchange rate target combined with an adjustment of domestic policies was able to stop upward pressure on a currency. However, would the Swiss National Bank have been prepared to give up monetary control to defend the “snake” parities in the same manner as it did in the crisis situation in 1978?

As mentioned earlier, in the course of the negotiations in 1975, Switzerland “undertook to consult with its “snake” partners to coordinate its exchange rate policy with that of its partners and, in the event of particularly strong pressure arising, to consider any measures to remedy the situation”. It is assumed that, by committing themselves to such an extent, the Swiss authorities were aware that a policy of strict monetary control (like that adopted at the end of 1975 when the negotiation had failed) would not have been compatible with a “snake” exchange rate target. However, it cannot be ascertained to what extent they would have been prepared to accommodate, for the sake of their exchange rate target, any excessive monetary growth. In this context, it has to be remembered that, despite the real appreciation of the Swiss franc, inflation was strong in Switzerland in the 1970s if measured in absolute rates of increase in the consumer price index (see above). Inflation rates were relatively low by international standards and similar to that in Germany but far away from those rates which could be deemed compatible with the notion of price stability as perceived by the Swiss National Bank. At least in the opinion of the latter, a loss of monetary control might have been adverse to its objective of maintaining price stability in the medium term. Thus, the Swiss authorities might have come under pressure if they had defended the exchange rate link with the “snake” by completely giving

up monetary control in an environment characterised by relatively strong inflationary pressure.

It must therefore remain an open question whether the association of the Swiss franc with the “snake” would actually have been a remedy to the dilemma with which the Swiss authorities were confronted in the 1970s. Since “snake” membership had not been within reach, there was no point in assessing officially whether it would have avoided the overvaluation of the Swiss franc.

When in 1978 the European Monetary System (EMS) was forthcoming, the Swiss National Bank decided, after a thorough examination, against a formal association with the successor regime of the “snake”. In the opinion of the Swiss authorities, such an association “would not present substantial monetary advantages while giving rise to problems with regard to the policy of integration.”[44] This statement does not necessarily convey the Swiss authorities' late perception that the association of the Swiss franc with the “snake” would have been unsustainable. In late 1978, the Swiss franc was clearly overvalued and an entry into the new EMS at the prevailing exchange rate level might have been deemed risky. However, the second part of the statement reveals the true dilemma of the Swiss monetary and exchange rate policy. Indeed a request for association with the EMS without the willingness to join the EEC would probably not have had a better chance of being accepted by the EMS member countries than the request formulated in 1975. Although the EMS Agreement provided explicitly for the association of non-EEC countries, the actual interest among the EMS participants in making use of this provision was relatively limited. Thus, when Norway ended the association of the krone with the “snake” in 1978 in the run-up to the EMS, there was little effort among the prospective EMS member countries to retain Norway.

3.3 Did the Community miss an opportunity to establish closer relationships with Switzerland?

Even if it is assumed that the association of the Swiss franc with the “snake” would have been sustainable in the longer run, it is unlikely that this would have changed the future development of relationships between the Community and Switzerland.

The history of European monetary integration teaches us that the success of all Community undertakings hinges on the political will for integration. A lack of political will accounted for the setbacks in the Community's endeavours in the 1970s. A growing perception of the need for integration in Europe and an increasing political willingness to pursue this goal brought about the success of the EMS and the eventual creation of Economic and Monetary Union (EMU). While monetary and exchange rate policy cooperation has played an important role in this process, the ultimate success depended on whether it was supported by the will for political integration.

Against this background, however successful the association of the Swiss franc with the “snake” might have been, it would not have helped to bring Switzerland closer to the Community than has actually been the case. As mentioned above, in 1975, the Swiss authorities perceived the “snake” as a regional exchange rate mechanism and a substitute for the worldwide regime of fixed exchange rates which had broken down in 1973. The association of the Swiss franc to this mechanism was a means to establish greater exchange rate stability against the Deutsche Mark, i.e. the currency of a neighbouring country with which Switzerland shared common values in economic policy. It did not imply Switzerland's willingness to participate in the endeavours for further integration at a Community level. This was made crystal clear by the Swiss authorities in 1975 and a more intense monetary and exchange rate policy cooperation with the Community, however successful it might have been, would not have changed anything in the scepticism which prevails in Switzerland about membership in the

European Union.

In fact, the opposition of the majority of the Swiss population to EU membership appears to originate from fundamental issues and seems to accentuate the more European integration proceeds and the more the close economic ties with the Community countries call for cooperation.[45] Successful cooperation might even be counterproductive if and when it is suspected to lead to membership in the Community. When the Swiss sovereign rejected membership in the European Economic Area (EEA), it did so because it perceived EEA membership as a step towards EU membership. Likewise, the bilateral agreements between Switzerland and the EU are currently suspected to prepare the ground for accession to the EU which is still the declared long-term goal of the Federal Council.

It may therefore be concluded that the Community did not miss an opportunity to improve its relationships with Switzerland more than they have actually developed in the last 30 years. While membership in the "snake" would have strengthened cooperation between the authorities, a historical review of the last 30 years suggests that this strengthened cooperation alone would not have overcome the reluctance of Switzerland to participate in the process of European integration. Without this prospect, monetary and exchange rate cooperation between Switzerland and the Community would have come to a turning point when the move to economic and monetary union was resumed by the Community.

4. Summary and conclusions

When, in March 1975, the Swiss National Bank entered into a dialogue with the Committee of Governors with a view to sounding out the possibility of a formal participation in European monetary cooperation, its intention was to associate the Swiss franc with a regional system of fixed exchange rates which was maintained by some (albeit not all) of Switzerland's most important European trading partners. The move was intended to contain the strong upward trend that was recorded by the Swiss franc in the aftermath of the breakdown of the Bretton Woods system of fixed exchange rates and the first oil price shock in 1973. It was also meant to represent Switzerland's contribution to the efforts to restore greater exchange rate stability in a new international monetary order. By contrast, it was not intended to signal increasing willingness of Switzerland to participate in the political integration of the European Community.

To the great surprise of the Swiss authorities whose endeavours were in particular supported by Germany, the sounding-out resulted in the conclusion that there was not unanimous support among the "snake" member countries for the Swiss request. Despite significant concessions offered by the Swiss National Bank, France insisted on its opposition to Switzerland's formal participation in European monetary cooperation. It is not sure that France's opposition was solely based on the concern that the association of such a strong currency like the Swiss franc might cause tensions in the "snake" (which, by the way, France left again in March 1976, less than 9 months after its return in July 1975). Instead, it appears that fundamental political concerns were the basis of France's opposition. In particular, the envisaged association was expected to put greater emphasis on the nature of the "snake" as a "Deutsche Mark zone" instead of an element in the move to economic and monetary union, a goal to which France still demonstrated its commitment.

It must necessarily remain an open question whether the association

of the Swiss franc with the “snake” would have permitted the much desired containment of the strong upward trend in the Swiss franc exchange rate which actually materialized in the 1970s. Admittedly, the underlying strength of the Swiss franc might have given rise to some problems for the cohesion of the “snake” and the Swiss authorities might have been required to forego monetary control for the sake of maintaining the exchange rate link. Likewise, the opposite scenario, i.e. a successful defence of “snake” membership, cannot be excluded either. In 1978, the Swiss authorities gave priority to the exchange rate and abandoned completely monetary control for some time. This policy change stabilised the Swiss franc exchange rate vis-à-vis the Deutsche Mark (and subsequently the euro) around a level which has prevailed over the last 25 years. A similar policy in the “snake” might have stabilised the Swiss franc below the level which it actually reached in 1978.

Irrespective of this question, it is obvious that, in 1975, the Community did not miss an opportunity to involve Switzerland more in European political integration than has hitherto taken place. As was made clear by the Swiss authorities, their wish to establish closer monetary and exchange rate policy cooperation with the Community did not imply their willingness to join the European Community. Neither was there the prospect that such closer cooperation in the monetary and exchange rate field would over time lead to more decisive steps towards Switzerland’s political integration in Europe. However, without such a prospect, the undertaking was bound to fail. Switzerland had to realise that closer monetary and exchange rate cooperation was not possible without political integration in the Community. Membership in the Community was unthinkable in 1975 and has remained an open issue until today. To the extent that the overvaluation of the Swiss franc which mainly materialised in the 1970s still impacts adversely on the state of the Swiss economy, this is to be considered as the price which Switzerland paid for remaining outside the process of

European integration.

Notes

[1] Renamed European Community (EC) in 1993 by the Treaty on European Union ("Maastricht Treaty").
[2] The Committee of Governors was established in 1964 by a Council Decision with a view to strengthening cooperation among the EEC central banks.
[3] In the context of its function as a platform for international monetary and financial cooperation, the BIS hosted the Secretariat of the Committee and served as the regular place for Committee meetings.
[4] See BIS (1975), page 26.
[5] Formally, the IMF member countries fixed parities in terms of gold. Given the official gold price of USD 42 per ounce of fine gold at which the United States Treasury converted US dollar balances held by foreign central banks, the gold parities were the basis for the central rates vis-à-vis the US dollar. According to the then prevailing IMF rules, spot exchange rates of non-US currencies were allowed to fluctuate around these US dollar central rates by a maximum of +/- 1.5%. The then members of the European Economic Community kept fluctuation margins at +/- 1%.
[6] BIS (1976), page. 167.
[7] BIS (1975), page 27.
[8] SNB (1982), page 218.
[9] SNB (1976), page 11.
[10] For an assessment, see SNB (1982), page 229.
[11] Kaeser (2003), page 48, who quotes the communication, dated 29 April 1975, from the Swiss National Bank to the Swiss Federal Council.
[12] See for instance the statement by E. F. Paltzer, General Manager of the Swiss Bank Corporation, to the annual meeting of 3 April 1975 (Neue Zürcher Zeitung, 4 April 1975).
[13] Kaeser (2003), page 11.
[14] See for instance the discussions held in the Schweizerischer Nationalrat (1975), Minutes of the sessions dated 5th, 11th and 20th March 1975.
[15] See for instance the speech by F. W. Schulthess, President of the Administrative Board of the Swiss Credit Corporation, at the 3rd Economic Conference of the Conference Board in Geneva in June 1975 ("Wie kann Europas Wirtschafts- und Währungslage saniert werden?", Finanz und Wirtschaft, 18 June 1975).
[16] Actually, this objective was only realised 20 years later with the transition to the third stage of Economic and Monetary Union (EMU) in January 1999.
[17] The Belgian and the Luxembourg francs were linked to each other by a 1:1 parity established in the framework of the monetary association between the two countries. The Banque Nationale de Belgique assumed the central bank function for both countries. Belgian banknotes were also legal tender in Luxembourg in addition to a limited amount of national banknotes that the Luxembourg authorities were entitled to issue. The monetary association between Belgium and Luxembourg was terminated at the start of Stage Three of EMU on 1 January 1999.
[18] The Irish pound was linked to the pound sterling by a fixed parity. This fixed parity was only abandoned in 1979 soon after the start of the European Monetary System (EMS) when the market rate of the Irish pound (member of the EMS) vis-à-vis the pound sterling (non-EMS member) moved away from the fixed parity.
[19] Resolution of the Council and of the representatives of the Governments of the Member States of 21 March 1972 on the application of the Resolution of 22 March 1971 on the attainment by stages of economic and monetary union in the Community (OJ No. C 38/3 of 18.4.1972).
[20] Agreement of 10 April 1972 between the Central Banks of the Member States of the Community on the narrowing of the margins of fluctuation between the Community currencies.
[21] The introduction of economic and monetary policy commitments as an element to ensure exchange rate stability came only with the European Monetary System, which superseded the "snake" in 1979.
[22] ECOFIN (1975c), page 3 and ECOFIN (1975e), page 5.
[23] The Governors' Alternates were in general Vice-Governors/Vice-Presidents or other members of the decision-making bodies of the respective central banks. From 1974, the Alternates met regularly on the eve of the meetings of the Committee of Governors with a view to preparing for the deliberation of the latter.
[24] The "experts" were senior central bank officials in the field of exchange rate policy and international affairs. They met as a group from 1971 mainly in the context of the establishment and management of the "snake". The group was chaired by Marcel Théron from the Banque de France (1971 to 1973), Francois Heyvaert from the Banque Nationale de Belgique (1974 to 1979) and Henning Dalgaard from Danmarks Nationalbank (1980 to 1992). It became the Foreign Exchange Policy Sub-Committee in 1990 following the entry into force of Stage One of EMU and continued under the auspices of the EMI at the start of Stage Two of EMU in 1994.
[25] See ECOFIN (1975d), page 8.
[26] Kaeser (2003), page 37.
[27] See ECOFIN (1975e), page 5.
[28] The Summit of Rambouillet was the first of the economic summits which subsequently became a regular feature in the framework of the G7. It was called by President Giscard d'Estaing and gathered the Heads of State or Government of France, Germany, Italy, Japan, the United Kingdom and the United States.
[29] See Kaeser (2003), page 41.
[30] Schweizerischer Bundesrat (1976), page 572. The assertion by Gianni Toniolo (2005), page 682, that, on 20 November 1975, the Swiss Parliament postponed in-

definitely the possible association of the Swiss franc with the “snake” lacks any foundation. There was no decision of this kind by the Swiss Parliament which in any case was not in session in November 1975.

[31] Detailed information is given by Daniel Kaeser (2003). Kaeser was a member of the Swiss delegation which met with the Ministers of Finance and central bank Governors on 22 September 1975.

[32] The chairmanship of the Committee rotated on an annual basis among the Governors according to seniority.

[33] The plan was presented by the then French Minister of Finance, Jean Pierre Fourcade, in September 1974.

[34] The so-called asymmetry of the “snake” remained a topic which was hotly debated throughout the 1970s. Most partners of Germany held the view that the mechanism put the burden of adjustment on weak currency countries instead of there being an equal burden sharing between weak and strong currency countries.

[35] Even without an association of the Swiss franc, it took 15 years before the United Kingdom joined the snake’s successor regime, the EMS.

[36] See Appendix III.

[37] “Les discussions furent interrompues à la fin de 1975 car la France s’opposait à une participation de la Suisse ou y mettait des conditions sans rapport avec la politique de change”, SNB (1982), page. 219.

[38] Kaeser (2003), page 33.

[39] SNB (1982), page 254. See also “Days of Swiss bank account system may be numbered”“, Financial Times, 18 June 1975.

[40] SNB (1982), page 254.

[41] In particular in the 1970s, the Deutsche Bundesbank was opposed to the use of the Deutsche Mark as a reserve and intervention currency by foreign monetary authorities unless agreed upon in special arrangements like the “snake”. This explains why the Swiss National Bank could not simply buy Deutsche Mark to stabilise the Swiss franc exchange rate vis-à-vis the Deutsche Mark. A bilateral agreement with the Deutsche Bundesbank to this effect apparently did not exist.

[42] According to the International Comparison Programme (IPC) of the World Bank Group (www.worldbank.org/data/icp), the ratio of the purchasing power parity (PPP) conversion factor to the US dollar/Swiss franc exchange rate was 1.2 in 2002. The corresponding ratios for most euro area countries (except for Greece) varied between 0.8 and 0.9 in the same period. The cross-comparison of these ratios implies that the Swiss franc exchange rate vis-à-vis the euro exceeds the Swiss PPP by more than 30%.

[43] See Hoffmeyer (1992), page. 127.

[44] “Apres un examen minutieux, notre pays renonça à une adhésion formelle, qui n’aurait guère procuré d’avantages monétaires substantielles, mais qui aurait soulevé de problèmes de politique d’intégration.” SNB (1982), page 219.

[45] For the reasons behind the growing “euro scepticism” in Switzerland, see Hollmann (2005), pages 35-45.

Appendix I: Chronology

May 1971	Germany lets the Deutsche Mark float.
August 1971	The United States suspend the gold convertibility of the US dollar.
December 1971	The "Smithsonian Agreement" establishes a new structure of US dollar parities. Return to fixed parities with a widened fluctuation margin of +/- 2.25%.
April 1972	The EEC Member States establish among themselves the mechanism for the progressive narrowing of the margins of fluctuation between their currencies (called "the snake").
May 1972	The accession countries Denmark, Ireland, Norway and the United Kingdom join the "snake".
June 1972	The UK and Ireland suspend membership of their currencies in the "snake". Norway stays as associate member in the "snake" following the negative outcome of the referendum on EEC membership.
January 1973	Switzerland lets its currency float.
February 1973	The United States devalue the US dollar by 10%. Japan lets the yen float. Italy leaves the "snake".
March 1973	Floating is generalised. The members of the "snake" agree on joint floating and admit Sweden as an associate member. Switzerland declines the invitation to participate in the joint float.
January 1974	France ceases to maintain the fluctuation margin between its currency and the other "snake" currencies.
March 1975	The Swiss National Bank starts exploring the possibility of associating the Swiss franc with the "snake".
April 1975	The Committee of Governors discusses the Swiss request without reaching a final conclusion.
May 1975	France announces the return of the French franc to the "snake". The Committee of Governors suspends its deliberation on the Swiss request.
July 1975	The French franc joins the "snake" after prior amendments to the Basle Agreement on the operating methods of the mechanism.
September 1975	The Ministers of Finance and the central bank Governors of the member countries of the "snake" meet a Swiss delegation led by the Minister of Finance and the President of the Swiss National Bank.
October 1975	The Committee of Governors invites the Swiss National Bank to join the arrangement for the regular exchange of information among the EEC central banks and with the central banks of some third countries ("concertation system").
November 1975	Switzerland puts off temporarily its request to associate the Swiss franc with the "snake".
December 1975	The Ministers of Finance and the central bank Governors of the member countries of the "snake" take note of split views among themselves and put off their deliberation on the Swiss request temporarily.
March 1976	France suspends membership in the "snake".
September 1978	The Swiss franc reaches an all-time high against both the US dollar and the Deutsche Mark. The Swiss authorities target an exchange rate level of clearly above CHF 0.80.

Appendix II: Switzerland's foreign exchange control measures between 1974 and 1978

Switzerland imposed various restrictions on short-term inflows of funds from 1971 onwards. They had gradually been removed in the aftermath of the first oil price shock in 1973 but were reactivated when upward pressure on the Swiss franc accentuated again towards the end of 1974.

In late November 1974, the prohibition of the payment of interest on non-resident Swiss franc deposits was reintroduced, together with a commission charge of 3% per quarter and reserve requirements, on all increases in non-resident Swiss franc deposits above the end-October 1974 level. To prevent these measures from being circumvented through the forward exchange market, Swiss banks were instructed to keep forward sales of francs to non-residents at or below the end-October 1974 level.[1]

In January 1975, exchange control was tightened further. The interest ban was applied to the total stock of non-resident franc deposits, and the commission charge was raised to 10% per quarter. At the same time, banks were instructed to reduce their forward sales of francs to non-residents and were prohibited from taking up overall (spot plus forward) short positions in all foreign currencies taken together. This measure was extended in April to cover positions in each of nine major currencies separately, as well as positions in all other foreign currencies taken together.[2]

The Swiss authorities also acted in November 1974 to ensure the prompt export of funds borrowed in the Swiss market by non-residents. To this end, they reintroduced immediate compulsory sale of the proceeds on the exchange market. In December 1974 this regulation was tightened up by requiring such conversions to be made at the Swiss National Bank. This regulation enlarged considerably the room for official intervention on the exchange market while limiting the impact on base money growth. In addition, the issue of franc-denominated loans and notes by non-residents was temporarily prohibited.[3]

Borrowing abroad by Swiss non-bank residents in Swiss francs and in foreign currencies was subject to authorisation by the Swiss National Bank. Such borrowing above a threshold of CHF1 million was only authorised if the whole of the credit was used abroad and foreign currency proceeds were not converted into Swiss francs.

In addition, in April 1975, the Swiss National Bank concluded an agreement with the Swiss banks and multinational corporations. In accordance with this gentleman's agreement, all foreign exchange operations exceeding USD 5 million were to be reported to the Swiss National Bank.[4] The aim of the compulsory reporting was not necessarily to be able to differentiate between commercial and financial operations. Instead, it was intended to give the Swiss authorities a better overall view of the exchange market and to give them advance notice of operations likely to disturb the market. The Swiss National Bank was thus in a position to advise against operations of a speculative nature or to provide offset for others.

In spring 1978, the Swiss authorities reinforced their direct controls on capital inflows. The 10% per quarter interest charge on non-resident Swiss franc deposits was extended to the accounts of central banks. A rather general ban was introduced on non-residents' acquisition of Swiss franc securities and limits on the import of foreign banknotes were introduced.[5]

As from 1979, all foreign exchange control measures were gradually relaxed. The last one, the prohibition to remunerate non-resident Swiss franc deposits, was abolished at the end of 1980.[6]

Appendix III: The “snake”

The “snake” was a regime of fixed but adjustable exchange rates among EEC currencies and other associated currencies. It was put into operation in April 1972 as one of the elements of the first phase of the move towards an economic and monetary union between the EEC Member States.

In the first phase of the move, the mechanism was to ensure that the margins of fluctuation between the EEC currencies were not wider than those vis-à-vis the US dollar. Under the prevailing IMF rules, each EEC Member State had fixed a reference rate vis-à-vis the US dollar with a margin of fluctuation which had been +/- 1% until December 1971 and +/- 2.25% until March 1973. Since December 1971, the margins of fluctuation between the EEC currencies had thus been +/- 4.5%, the double of those vis-à-vis the US dollar. By reducing the latter margin of fluctuation to +/- 2.25%, the mechanism established a band which fluctuated vis-à-vis the US dollar (hence the term “snake”). Until March 1973, the “snake” fluctuated within a fixed band vis-à-vis the US dollar (the “tunnel”), established by the upper and lower intervention rates vis-à-vis the US dollar. With the decision taken by the Member States of the “snake” in March 1973 to let their currencies jointly float, the “tunnel” was abandoned.

The rules for operating the “snake” were laid down in an Agreement concluded between the central banks of the EEC Member States in Basle (therefore called “Accord de Bâle”) in April 1972.[7] With a view to defending the margins of fluctuation between their currencies, each member central bank was obliged to intervene on the foreign exchange markets at the respective margins in the currencies of its partners. To this end, the intervention mechanism of the “snake” enabled each member central bank whose currency had reached the lower intervention point vis-à-vis another member currency to draw unlimited amounts of the latter currency from the respective issuing central bank. Conversely, the central bank with the strong currency had to buy unlimited amounts of the weakest currency.

A very short-term financing mechanism ensured that balances arising from interventions at the margins did not need to be settled immediately in foreign reserve assets but only at the end of the subsequent month. The initial maturity of very short-term financing operations could be extended for three months by mutual agreement between the debtor and the creditor central banks. As from July 1975, the amended rules entitled the debtor central bank to request a renewal for three months subject to certain limits. The Short-Term Monetary Support (STMS) mechanism that had already been created among the EEC central banks in 1970[8] could provide further short-term balance-of-payments financing if necessary.[9]

The balances arising from the very short-term financing operations were initially denominated in the currency of the creditor central bank. After June 1973, these balances were booked in a common monetary unit,[10] and thereby mulitlateralised, by the newly established European Monetary Cooperation Fund (EMCF)[11] with a view to facilitating intra-Community settlements. The EMCF was intended to become the core of the future European central bank system but in the first phase its function was limited to accounting for balances arising from intervention carried out in Community currencies and to “administering” the financing and credit mechanisms of the “snake”.[12] This accounting function was actually performed by the Bank for International Settlements in Basle which acted as agent of the EMCF in accordance with the directives issued by the Board of Governors of the EMCF.

At their maturity, very short-term financing operations were to be settled, in predetermined proportions, in gold, SDRs, IMF reserve positions and US dollars. As from July 1975, gold was excluded as a compulsory means of settlement.

The “snake” started in spring 1972 with the participation of the currencies of the six EEC founding member countries and the accession

countries which were to join the EEC in January 1973. However, during most of its existence, the "snake" was a joint float of the Deutsche Mark, the Benelux currencies, the Danish krone and two associated currencies, the Norwegian kroner and the Swedish krona. The association of the Norwegian and Swedish currencies with the "snake" was governed by bilateral agreements with each ordinary "snake" member central bank. Although these agreements were not fully identical, they were similar and provided in particular for automatic, compulsory and unlimited intervention at the margins and, up to certain limits, very short-term financing of the bilateral balances arising from these interventions. In contrast to the intervention balances between Community member central banks, those between associated and ordinary "snake" member central banks were not accounted for and multilateralised by the EMCF. Furthermore, the associated members did not have access to the STMS mechanism.
Between April 1972 and March 1979 (when the "snake" was superseded by the European Monetary System (EMS)), there were 17 changes in parities. They mainly consisted of revaluations of the Deutsche Mark vis-à-vis its partner currencies or devaluations of the latter, respectively.

Notes to appendixes

[1] BIS (1976), page 124.
[2] BIS (1976), page 125.
[3] BIS (1976), page 125.
[4] BIS (1976), page 123.
[5] BIS (1979), page 137.
[6] SNB (1982), page 229.
[7] Agreement of 10 April 1972 between the Central Banks of the Member States of the Community on the narrowing of the margins of fluctuation between the Community currencies.
[8] Agreement setting up a system of short-term monetary support among the central banks of the Member States of the European Economic Community, 9 February 1970, reproduced in European Communities, Monetary Committee*, Compendium of Community Monetary Texts*, 1974, pages 67-70.
[9] Actually, the STMC mechanism was never used by "snake" member central banks to extend the financing of debt incurred in the framework of the "snake". The only use made of it was by a non-snake central bank, i.e. the Banca d'Italia, in 1974. See BIS (1980a), page 74.
[10] The common monetary unit was the European Monetary Unit of Account (EMUA). According to Article 5 of the Statutes of the EMCF, the value of the EMUA was equivalent to 0.88867088 grammes of fine gold. The denomination of very short-term financing operations in EMUA protected the debtor against a revaluation of the creditor currency and the creditor against the devaluation of a debtor currency.
[11] Regulation (EEC) No. 907/73 of the Council of 3 April 1973 establishing a European Monetary Cooperation Fund, OJ No. L 89, 5.4.1973, page 4.
[12] See Article 3 of the aforementioned Regulation (EEC) No. 907/73.

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