The European Monetary System

Economic and Monetary Union (EMU) had been an objective of the European Community since 1969. The European Monetary System (EMS) was one of the systems introduced and it can be seen as the precursor to the creation of the single European currency.

The EMS, based on a proposal made by the president of the European Commission, Roy Jenkins, was launched in March 1979. It included all the Member States’ currencies, except for the British pound. The system was designed to make all the currencies stable against each other, allowing only limited fluctuations against a central rate. This central rate was the European Currency Unit (ECU), an artificial currency based on a basket of member currencies. The fluctuations, which were controlled through the Exchange Rate Mechanism (ERM), had to be kept within +/- 2.25% of the central rate. The Italian lira, Spanish peseta, Portuguese escudo, and the British pound, which joined the system in 1990, were allowed to fluctuate by 6%. If the exchange rate of a currency reached 75% of this authorised margin, the country’s government had to adjust their interest rates and fiscal policy in order to keep the currency in line. If the maximum margin was reached, the country’s central bank had to intervene by buying or selling the currency in order to avoid exceeding the margin. In 1992, turmoil hit the EMS and the British pound and Italian lira had to withdraw from the ERM – Italy rejoined later but the UK did not – and the following year the fluctuation margins were increased to 15% because of speculation.

Source – BBC News – © 2005