

**Delegation of the Commission
of the European Communities
to the United Nations.**

1 Dag Hammarskjöld Plaza
245 East 47th Street
New York, NY 10017
Telephone: (212) 371-3804
Telex: 01-2396
Cable: EURCOM

EMBARGO : Monday November 20, 1978
1:00 P.M.

ADDRESS BY MR. RICHARD BURKE
MEMBER OF THE COMMISSION OF THE EUROPEAN COMMUNITIES
BEFORE THE BELGIAN-AMERICAN CHAMBER OF COMMERCE
AND THE CHICAGO CHAMBER OF COMMERCE & INDUSTRY

" The New European Monetary System and the Dollar "

Mr Chairman, Ladies and Gentlemen

Let me begin by saying how pleased I am to have this opportunity of speaking to you. It is a pleasure to be here in Chicago, the heart of the midwest, and to have this possibility of exchanging views and ideas with its business leaders. Given the subject of my remarks today, I would add that it is a particular pleasure - and I hope an inspiration - to be at or near the geographical center of the world's most successful experiment in economic and monetary union.

For the great effort which is now under way in Europe is directed towards the eventual achievement of a union on a scale and with a coherence to match your American achievement. At the moment we are engaged on what may be regarded as a preliminary step towards the achievement of that union and it is about the details of that step that I wish to talk today.

But before I become immersed in the technical

details I should say that the European Monetary System, which is now the subject of deep and sometimes difficult discussion between our member states, and which will, I hope, be agreed on at the meeting of the European Council in two weeks time, is but a preliminary step to the establishment of Economic and Monetary Union in Europe.

This union - E.M.U. as it is known - has had a rather troubled history. Indeed quite recently there were those who claimed that it was an idea whose time had gone. Some claimed that "EMU" had suffered the fate of the Australian bird of the same name which is now unhappily extinct. Since the economic crisis of 1973 Europeans have been increasingly aware of the divergencies between their countries rather than the similarities: it was undeniable that the disparity between the strongest and the weakest regions of the Community was growing, and that in that context orthodox economic thinkers tended to suppose that the dream of economic and monetary union would have to be set aside for this generation.

It was in this cold climate that the Commission, meeting at La Roche in the Ardennes, nevertheless decided a year ago to revive the aspiration towards E.M.U. It argued that because the Community was losing cohesion under the stress of economic difficulties, it had become all the more necessary to take a courageous initiative instead of awaiting the verdict of events. The virtual disappearance of the Bretton Woods system which had followed the dollar crisis of August 1971 and the rise and fall of the Smithsonian system, abandoned for a system of floating exchange rates by the end of 1973, made the creation of a successor system all the more pressing.

The President of the Commission, Roy Jenkins, in a major speech at Florence urged that, precisely because the Community had lost the props which had made possible the progress of the 'sixties, a "qualitative leap forward" was called for, if needs be in the face of serious difficulties. He proposed

that European leaders should make a political choice in favour of economic and monetary union, regardless of how discouraging the objective economic indicators might be.

It would not be true to say that this revival of E.M.U. was greeted everywhere with acclaim. Indeed in the early stages the sceptics probably outnumbered the enthusiasts. But in the space of a few months the idea made its way in the most important circles, namely in the Economic Councils of the member state governments, and in particular in the thinking of the French and German leaders. It is true that largely unforeseen circumstances, external in their nature, tended to concentrate their minds in the direction proposed by the Commission. In particular the steady decline of the dollar forced the strong currency countries in Europe to look for a new line of security. It is also true that the scheme which engages our attention now is but a step towards the economic and monetary union which the Commission put forward. But it would not be right, at the outset of a discussion of the limited system of monetary integration which is now at hand, to understate the importance of the imaginative political contribution made by the President of the European Commission.

The great aim of E.M.U. is to create a single monetary system which will operate throughout the nine member states of our European Community, in much the same way as the dollar does throughout the United States. Some five months ago, in the German city of Bremen, those nine countries agreed to establish a common monetary system and to bring it into operation by the beginning of the new year. This system will be a crucial step towards the achievement of a full European economic Union.

One can view the European Monetary System - E.M.S. as it has come to be called - in isolation, as a mere mechanical framework designed to create a zone of exchange rate stability, and to help to bring about a greater convergence of economic policies in the member states. To do so would, I believe, greatly understate the real nature of those proposals.

Let us revert once more to the historical background against which the idea evolved. The original proposal for establishing the European Economic and Monetary Union were made at the Hague some nine years ago. They envisaged its establishment in three distinct phases. The first of these involved the coordination of short term economic and budgetary policies amongst the six countries who formed the Community at the time. (Ireland, Denmark and Great Britain did not, of course, join the Community until 1973, and were therefore not eligible to participate in the experiment mooted in 1969).

To this initial action of coordination there was added suggestion of preliminary harmonisation of corporate and personal taxation - otherwise a single currency Europe with free capital movement would become a series of competing tax havens. This first phase was to have been followed by a period in which economic policies, both short and medium term, would be formulated jointly. At the same time, capital movements would be freed and tight exchange rate margins maintained.

The first stage was to see the creation of an EEC Central Bank and Reserve Fund, free capital movement and the removal of tax frontiers.

As happens so often we became wiser after the event. A number of events which could not have been foreseen combined to make the achievement of this ambitious programme much more difficult than could have been imagined. Perhaps the single most important development was the energy crisis of 1973 and the recession which followed it. The political will needed to carry out what were in fact far reaching changes in national policies was absent, in the face of adverse economic circumstances. There were other weaknesses too. The huge number of consultative bodies necessitated by the proposal as originally formulated created a burden quite out of proportion to the results that their meetings produced. Differing rates of inflation and differing reactions to the existence of high inflation made the coordination, and particularly the convergence of economic policies difficult in the short term. So too did differing rates of growth in productivity. Budgetary pressures at national level, a reflection of a parlous economic equilibrium, had restricted

the scope of the necessary coordination, and indeed the size of the necessary financial instruments so that the resource transfers between the member states could not meet the requirements posited by the programme.

But despite the disappointing experience, the idea remained attractive. Fundamentally of course the strength of that attraction derives from a deep-seated feeling amongst European statesmen that such a step would be a catalyst, an impetus to the political union of our nine countries. For it is clear that the merging of our economies in this fashion implies a centralisation of economic and financial policy making in the central institutions with a concomitantly far-reaching reinforcement of those institutions. In time, responsibility for macro-economic policy, for external economic relations and for that essential element of an equitable union, I mean the management of resource transfers between the stronger and the weaker regions, would pass to the central institutions.

Quite clearly by reducing what I might call the bureaucratic segmentation of the European continent this process would allow for a much more effective employment of our economic resources, with consequent gains in productivity, trading strength and living standards. It is not surprising then that as we recovered from the economic setbacks of the mid 70s European leaders were determined not to be discouraged by the difficulties encountered but to rather see in them a challenge to be overcome. When therefore, the idea of economic and monetary union was revived the question posed was not whether we should seek it but rather which of three possible approaches to the attainment of the union seemed to hold the most promise.

The three alternatives were roughly as follows : we could continue the policy of small steps forward, recalling that a good deal of what had already been achieved despite the adverse circumstances of the 70s in terms of the abolition of tariffs and the establishment of free movement for labour and capital..We could seek by means of a great leap forward an early monetary integration. Or we could decide to defer the attempt at integration until a much greater degree of market unity had been

unity had been achieved.

The outcome of the Bremen meeting last June was a compromise embodying elements of all three possibilities. It was a decision to set up a European Monetary System.

The proposals made at Bremen were of great importance. They were to study ways of stabilising currencies in Europe by creating a system of strict exchange relationships, the establishment of a well endowed pool of reserves and the creation of a reserve currency based on the European unit of account. It was recognised that if the errors of the original initiative were to be avoided, if in fact the weaker countries were to be able to stay in the system, politically acceptable ways of bringing inflation rates into line would have to be found and means of strengthening the weaker economies would be necessary.

It is accepted that if the system is to work smoothly and to be durable, not to say credible, it is necessary

to ensure that inflation rates which now range between slightly over 11.5 percent in Italy to a little more than 2 percent in Germany should converge without at the same time generating through that convergence unacceptably deflationary effects. The cure must not, one might say, be lethal to the patient. Such a convergence of inflation rates at a moderate level is the best way of ensuring stable exchange rates and a balance of payments equilibrium. This objective should be an integral part of a wider strategy which includes other important social and economic aims such as, in particular, sustained growth gradually leading to full employment, a convergence of living standards, and the reduction of regional imbalances. These are desirable aims which will not be achieved without sustained effort and careful planning.

To ensure the success of the Bremen strategy and in order to allow all member states to participate, the necessary institutional conditions to obtain convergence in policies need to be promoted. In particular, monetary policies must come together gradually with the system's stability in view and budgetary and monetary policies must be brought towards mutual consistency with integration in a short-term and in a medium-term context and should be directed

IN THE CONTEXT OF SUCH CONCERTED ACTIONS, ADJUSTMENT POLICY - INCLUDING, WHEN NECESSARY, ADJUSTMENTS IN EXCHANGE RATES - WILL HAVE TO BE BASED ON A SYMMETRY BETWEEN THE RIGHTS AND OBLIGATIONS OF THE PARTICIPANTS. THIS SYMMETRY MEANS THAT DEFICIT COUNTRIES SHOULD PURSUE A POLICY TO RESTORE BASIC EQUILIBRIUM AND TO REDUCE INFLATION RATES., IN PARALLEL, IN THE SURPLUS COUNTRIES THERE SHOULD BE AN EXPANSION OF INTERNAL DEMAND, WITHOUT THIS HAVING ANY INFLATIONARY EFFECTS. THE SITUATION OF BOTH SURPLUS AND DEFICIT COUNTRIES WOULD BE EXAMINED AT COMMUNITY LEVEL WITH A VIEW TO ASSESSING POSSIBLE MEASURES TO BE TAKEN AS AND WHEN THE SYSTEM IS THREATENED WITH IMBALANCE.

ACHIEVING THE DESIRED CONVERGENCE OF ECONOMIC POLICIES WILL MEET CERTAIN DIFFICULTIES GIVEN THE VARYING IMPORTANCE THAT THE OBJECTIVES OF GROWTH AND EMPLOYMENT ASSUME IN THE VARIOUS MEMBER STATES AS A CONSEQUENCE OF THEIR DIFFERENT LEVELS OF DEVELOPMENT AND UNEMPLOYMENT.

IN PARTICULAR, THE LESS PROSPEROUS MEMBER COUNTRIES - HOWEVER ENERGETIC AND WELL DESIGNED THEIR EFFORTS MIGHT BE - WILL FACE, BOTH TRANSITIONAL PROBLEMS AS THEY ADJUST TO THE DIFFERENT EXCHANGE RATE REGIME OF THE EMS AND LONGER TERM DIFFICULTIES IN RECONCILING CONTINUED STABLE PARTICIPATION IN THE SYSTEM WITH PURSUIT OF THEIR GROWTH, INCOME AND EMPLOYMENT GOALS. BUT THE FUTURE MUST LOOK AFTER ITSELF. THE TRANSITIONAL PROBLEMS ARE OF MORE IMMEDIATE CONCERN AND I WOULD SAY THAT THE FOLLOWING FACTORS ARE PARTICULARLY RELEVANT TO THE POSITION OF THE LESS PROSPEROUS MEMBER COUNTRIES :

FIRST, THE POSSIBILITY THAT THE BALANCE OF PAYMENTS WOULD BECOME A MORE IMPORTANT CONCERN OF ECONOMIC POLICY, TO THE DETRIMENT OF OTHER OBJECTIVES, PARTICULARLY GROWTH AND EMPLOYMENT CREATION:

SECOND, THE FACT THAT PARTICIPATION IN THE EMS ON A STABLE BASIS IMPLIES LESS FLEXIBILITY IN EXCHANGE RATES, AND THUS, IN THE ABSENCE OF OFFSETTING MEASURES, REDUCES THE POTENTIAL OF ECONOMIC POLICY INSTRUMENTS WHILE LEAVING UNCHANGED THE NUMBER OF POLICY OBJECTIVES:

THIRD, THE POSSIBILITY THAT EMS WOULD LEAD TO FASTER CONVERGENCE OF FACTOR PRICES (LABOUR AND CAPITAL) THAN OF PRODUCTIVITY LEVELS, WITH CONSEQUENTIAL GENERATION OF FORCES TENDING TO DRAW CAPITAL AND LABOUR FROM THE LESS PROSPEROUS MEMBER COUNTRIES:

FOURTH, THE PROBABILITY OF A LAG IN THE ADJUSTMENT OF EXPECTATIONS (E.G. ON WAGE RISES) TO THE ASSUMED LOWER INFLATION RATE WHICH WOULD FOLLOW FROM PARTICIPATION IN THE EMS AND THE DIFFICULTIES THIS WOULD CAUSE FOR ECONOMIC POLICY.

THERE IS MORE THAN THE NORMAL UNCERTAINTY ABOUT ECONOMIC FORECASTING INVOLVED IN THIS CAUTIOUS RESPONSE. FOR THE IMPACT OF THE NEW SYSTEM ON THE EXCHANGES WILL BE TO A GREAT EXTENT DETERMINED BY ITS TECHNICAL STRUCTURE, AND IN PARTICULAR BY WHETHER WE ARE TO HAVE THE BASKED SYSTEM OR THE SO-CALLED PARITY GRID SYSTEM. AND THAT DECISION HAS YET TO BE MADE.

STRATEGICALLY, HOWEVER, I HAVE NO DOUBT THAT A STRENGTHENING OF THE EUROPEAN CURRENCIES WITH ITS CONSEQUENT DEMPENING OF THE TURBULENCE OF THE EXCHANGE MARKETS CANNOT BUT BE BENEFICIAL TO THE DOLLAR. ONE DOES NOT HAVE TO UNDERLINE TODAY THE DESTABLISHING EFFECTS OF MONETARY SPECULATION ON INVESTMENT AND TRADING CONDITIONS. OUR SYSTEM, I BELIEVE, WILL DISCOURAGE THAT SPECULATION, EVEN IF IT CANNOT ALTOGETHER ABOLISH IT.

I WOULD GO FURTEHR INDEED IN SUGGESTING THAT THE US HAS EVERY INTEREST IN ENCOURAGING THE EMERGENCE OF AN ECONOMICALLY STRONG AND OUTWARD-LOOKING COMMUNITY. A PROSPEROUS NON-PROTECTIONIST EUROPE OFFERS A MARKET OF SOME 250 MILLION CONSUMERS FOR AMERICAN PRODUCTS AND YOUR MARKETING CAN ONLY BE SIMPLIFIED WHEN IT IS CONDUCTED IN A UNIFIED AND STABLE MONETARY SYSTEM.

I DO NOT DENY THAT FROM DAY TO DAY THE US AND THE COMMUNITY MAY BE IN SHARP DISAGREEMENT ABOUT ONE POINT OR ANOTHER OF ECONOMIC OR FINANCIAL POLICY. I DO NOT PRETEND THAT WE ARE NOT IN MANY INSTANCES COMPETITORS. BUT I BELIEVE YOU WILL ACCEPT THAT IT HAS ALWAYS BEEN IN THE LONG TERM INTEREST OF THE UNITED STATES TO BE ABLE TO DEPEND ON THE PARTNERSHIP OF A STRONG AND STABLE EUROPE, AND IN THAT SPIRIT I AM CONFIDENT THAT THIS BOLD ADVANCE TOWARDS MONETARY COHESION AND EVENTUAL ECONOMIC UNION CAN ONLY BE TO THE HISTORIC BENEFIT OF BOTH CONTINENTS.

I AM SURE I DO NOT HAVE TO LABOUR THE THEME AT A MEETING OF THE BELGIAN-AMERICAN CHAMBER OF THE CHICAGO ASSOCIATION. HOWEVER SCEPTICAL MY RECEPTION MIGHT BE IN A MORE PURELY NATIVE FORUM, SO I CONCLUDED HERE IN THANKING YOU MOST WARMLY FOR THE KINDNESS, HOSPITALITY AND ATTENTION WHICH YOU HAVE SHOWN ME.