TOWARD A COMMON EUROPEAN CURRENCY

Address by

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I. National sovereignty and currencies

I am most grateful to this Institution for the opportunity it provides me to state some views on the problems of monetary integration in the E.E.C. But I am also well aware of doing this in front of such distinguished experts in the field and not in the least among them one whom I have considered for many years as my master. By the way, I do not know if this acknowledgement will please him.

As you probably will know, the academic life is like the creation of the universe, code epoch following another one, some new species coming to life, some old ones vanishing and some other ones degenerating. Now this is especially true for that kind of species known as "Economist", some of them have managed to keep all their characteristics, some have evolved as business or administration economists and,alas, some others have degenerated into an almost unrecognizable category: the politician economist of whom you see before you, a representative.

Since the emergence in the 19th century of an "international economy", no concept has been more relative than that of national sovereignty in monetary matters. And the principle between the different currencies has been even more questionable.

For more than a century the rule has been that currencies exist side by side in the hands of transactors - or of certain major categories of transactors - in a sort of hierarchical pattern of monetary systems. Some currencies have been virtually universal: gold for part of the 19th century, followed by sterling, and now the dollar since the thirties. There are regional currencies whose roles, increasing or declining, cover a limited number of countries: the most outstanding example is sterling since the thirties; also the franc and the mark before the first World War; the German Mark, expecially in the context of the "reduced snake", can be considered as an embryo of a regional currency. Finally there are national monetary areas within which, for centuries, the law has sought to give the prince the monopoly of issuing legal tender; but this monopoly has never been absolute, since it is constantly limited by the competition from some currencies issued by other princes.

The role of the "Nation-State" in the monetary organization declined during the period of the gold standard: between 1875 and 1914 the situation of the western world (and of its dependencies) was like that of a sort of generalized monetary union. The Nation State increased its monetary role in the inter-war years. But after the second world war this role tended again to diminish: the national currencies gave over so many of their functions to the dollar that the international monetary relations were frequently likened to a universal dollar standard. During a certain period, this system worked apparently well, although it implied inevitably some strains within the "underlying" Nation States; strains

resulting from an eventual conflict between the need to make allowance for the effects of US monetary policy on the national economic situation and the pursuit of national objectives.

By the end of the sixties, the system ran into repeated international crises. These developments triggered of reactions which gave rise to a powerful current of though hostile to the system of stable exchange rates set up by the IMF Articles of Agreement.

In the purest form, the floating excange rate method is free trade and universalist inspired (absence of all government intervention in external monetary policy). But in practice things are different: government cannot allow that their economic policies, or the levels of employment, be exposed to "unreasonable" speculative movements. So at lease for the more important countries, clean floating is only a academic construction; dirty floating is the real alternative. And we know from the experience of the thirties that this method can lead from monetary nationalism to economic nationalism.

It must also be stressed that floating exchange rates can lead to a "vicious circle": the higher cost of imports adds to inflationary pressure. The recent examples of the United Kindom and Italy are a striking illustration of these dangers.

On the other hand, countries with a currency that tends to be relatively strong in relation to the others are in a better situation with floating rates, particularly if their economy is of a "dominant type" (as Perroux would call it) and large enough to set off a chain reaction. These countries export their inflation - their products being bough at any rate - and, insofar as a large proportion of their markets are in the

countries affected by the chain reaction, the effects on exports and employment is reduced. It is no doubt a chain reaction of this type that starts the process whereby a strong currency, with a sufficiently broad economic base, tends to move beyond the national frontiers to become a key currency to reserve currency at regional or international level.

The controversy on the subject of fixed or flexible exchange rates led a growing of economists to affirm that neither the national pole nor the universal pole of monetary organization provide the possibility of an optimum organization of monetary relations. The fundamental idea is that from the point of view of the economic optimum, monetary and national frontiers do not necessarily coincide.

So, to speak of European National States, they can choose between the will to satisfy some of their own political and social objectives and the will to take advantage of the benefits flowing from the continuity and expansion of economic transactions across frontiers.

If the latter should predominate, and the economies in question open up to each other beyond a certain level, then the factors of production themselves (capital, enterprises,...) will develop a high degree of mobility, the difference between the political and social objectives will wane and adjustments will tend to be made through moderate changes in the application of economic policy instruments. At a certain stage, managing the exchange rate becomes meaningless of undesirable. All the characteristics of an "optimum currency area" will then be present.

At a time noted for the economic interventionism of the of the public authorities, such a development cannot occur without deliberate harmonization of the policies of the States concerned. It is sometimes added (Werner Report) that it is essential to set up a decision-making center for certain fields. However it will become clear that the scope and incidence of such an approach could differ, depending on which of two patterns is generally followed: the gradual narrowing of margins between the currencies of the Member States, or the creation of a common currency which would exist side by side with national currencies.

A few more specific indications on the steps the European countries might take along the path indicated above would now seem appropriate.

II. Why a common European currency?

While the Treaty of Rome did not introduce the tendency towards regional integration, it is important for having more or less explicitly acknowledged that the Nation State is no longer the optimal production area and the optimal trading area.

The Nation State has ceased to be the exclusive, and in some countries and under certain conditions, even predominant framework of economic life, and the importance of the regional context has been confirmed. This has had a considerable impact on material well-being and growth, which would be difficult to call into question.

It would seem that these changes could have occurred without more or less parallel changes in the monetary field if the

universal dollar standard had been established smoothly. Just as in the 19th century the Western world moved into a universal monetary union based on the gold standard, Europe could, and still can, move into a similar system based on the dollar.

In this connection, it should be emphasized that on the effective basis provided by the dollar, European monetary relations developed without any major disruptions (one revaluation of the German mark) from 1958 to 1968, inside a "tunnell" of 1.50%. Why then has a"tunnel" of 4.5% become untenable today?, and also a "snake" of 2.25%.

The immediate reply to this question is the growth of inflationary pressures and their uneven development in the different European countries. But this begs another question. What is behind the disturbances which have made it impossible for the European currencies to coexist inside the margins of Fluctuation, even when expanded?

No-one has yet measured the share of responsibility that can be attributed to strains born of divergences in European national policies, and the role played directly or indirectly by the impulses triggered by inflationary pressure in the United States. This pressure is transmitted both by the "real" effects ofan increase in American demand and by the "monetary" effects stemming from the operation of the international monetary system in force until the beginning of 1973 (stable rates, intervention in dollars) during a period of rapid and substantial increases in the deficit of the United States.

Be that as it may, these pressures were too strong for the fragile framework of progress towards European monetary union, originally (Werner Report) conceived as a sort of slightly amended version of the universal standard system (the method of the Community "snake" in the dollar "tunnel" to be implemented only by intervention in dollars).

In the great debate which had begun on the virtues of this scheme, the "economists" readily predicted the early end of the "snake" on the grounds of existing and foreseeable deficiencies in the harmonization of policies. They were unaware of a danger which the "monetarists" also failed to point out: the pressures on the snake itself originating in the instability of the dollar. The monetarists merely asserted that monetary mechanisms would have the effect of mitigating, or even eliminating the deficiences of harmonization. In other words, they wanted to achieve economic integration by building on monetary integration, which is impossible.

The lessons drawn from the snake's various mishaps tend to be exaggerated, to say the least. In short, it is asserted that one should guard against embarking on new monetary adventures. This is taken to mean that the isolated floating of the main European currencies is inevitable at the present time and that currencies which have left the "snake" should not be allowed to return to it, at least until policies have been sufficiently harmonized. But there is some reluctance to calculate the distance to be travelled and anticipate the consequences ofthe establishment of a "mark area" which the German authorities themselves have constantly insisted that they did not want.

This tendency is dangerous in more than one respect for the Community's future. It cannot fail to have serious consequences for "real integration" in Europe, and even if the danger of protectionist outbidding is ignored, it will make it even more difficult to combat the effects of the oil crisis.

In view of the considerable difficulties affecting sterling and the lira, itis hard to imagine these currencies returning to the snake in the forseeable future; however this prospect does not look utopian as far as the French franc is concerned. With this in mind, it would be sensible to introduce immediately some machinery based on the experience gained with the functions of the snake. It might will be necessary to refrain from proclaiming for all to hear the possible size of an "enlarged snake", and, for some time to be satisfied with moving towards the reintroduction of some sort of Community margins, but using Flexible methods. Such a structure would, by itself, justify a start in pooling reserves, but its main purpose, at the present time, would be to force a rapid solution to the gold problem and to make it possible to begin the process of creating a common European currency - later referred to as the "Europa" - to replace the dollar in its functions as "key currency" within Europe.

We must have no illusions on this subject. The creation of a "Europe" in anticipation of the recent period of amrked instability of the dollar, and the transfer to a common European currency of the functions reserved in practice for the US currency (in particular intervention for the purpose of managing the foreign exchange markets) might perhaps have spared Europe some disruptions.

However, the present outlook is for the US economy to stability, and we must not therefore expect that recourse to the "Europa" would, in the immediate future, be in any way an improvement on the technical efficiency of the dollar in its functions as an international currency (intervention, settlements, reserves).

Indeed the actual situation is not very much in favour of a new process towards European monetary integration. As a consequence of the energy crisis, the weakness of some European currencies - and economies - has become more apparent, the strength of the American economy has been better appreciated, and the dominant role of the dollar is again largely accepted. This would mean that any ideas about regional monetary poles become less attrative; in other words, that we are moving away from monetary regionalism, and that the universal dollar-based system could again - in a slightly modified form - rule our international monetary relations, for some years at least.

Some form of regionalism could (continue to) develop inside the universal dollar-system, on the basis of the German economy and the German Mark on the one side, and the yen on the other side. As far as Europe is concerned, the "snake-of-five-countries" is already an embryo of the described mixture.

But I would like to add one fundamental consideration. The arguments mentioned above only take into account the economic and monetary forces at play. But the European monetary integration has not only been initiated and pushed on the basis of economic considerations.

From the very beginning, it has been an outstanding aim of our monetary integration to be a powerful argument on the road to political integration. As is stated in the Conclusions of the Werner Report:

" Economic and monetary union means that the principal decisions of economic policy will be taken at Community level and therefore that the necessary powers will be transferred from the national plane to the Community plane. These transfers of responsibility and the creation of the corresponding Community institutions represent a precess of fundamental political cooperation. The economic and monetary union thus appears as a leaven for the development of political union which in the long run it will be unable to do without. "

III. How can a common European currency be achieved?

European monetary union should be pursued by either by coordinating exchange rate policies (the "snake" method or creating a common currency.

For progress to be made in implementing the method of coordinating exchange rate policies there will have to be progress in coordinating economic policies. In the present state of affairs, it is not possible for exchange rate policies to be fitted into a narrow band(the "snake"0 which is valid for all currencies. It is necessary to await more favourable circumstances and in the meantime to have a "joint float" Community currencies. It is impossible to say at present just how long it will be before such an operation could lead to exact fluctuation margins being defined for all EEC currencies and then these margins being narrowed by stages.

Let us face the grim reality:
Never, Since many years, has there been in the European Community such a disarroy and such a discrepancy between robot Governmentssay and what they do. They are powerless in front of evolution of the economic situation. They are no more able to use effectively the instruments of monetary cooperation. They are most of the time out of step in their economic policies and when not it is much the consequence of haphazardly taken decisions that the result of their common political will.
In the field of international monetary policy there are few who still believe Curope is endowed with the power to influence the American attitude regarding the international monetary reform and the evolution of their balance of payments; Espically now, that the time seems to have arrived at which the US will give handling Europe with " begning neglect"

The stages approach should be adopted and applied to bringing a common currency into operation. Three main stages might be proposed:

I. A brief preliminary stage, primarily to launch the common currency;

II. An intermediate stage during which use of the common currency would be developed so that it could eventually replace the dollar as an intervention currency, which implies that it would be circulating widely in the marker; its position in relation to the national currencies would then be similar to that of the dollar and the Euro-dollar today; to be more precise, during this stage, theright to modify exchange relationship between the common currency and the national currencies would still exist; this stage would be of indefinite duration, and likely to be long;

III. In the final stage exchange rate relationship between the common European currency and the national currencies would be finally fixed and the fluctuation margins would have disappeared, (the narrowing of margins having been completed); the economic andmonetary consequences of this state of affairs would be almost identical to those corresponding to the disappearance of national currencies and their replacement by the common European currency which had become the sole one.

I would like to mention in this context that I have always considered that in any case, whatever method of monetary integration is followed, the co-existence of national currencies and a European currency during a long number of years seems unavoidable. A national currency has very deep roots in the "economic psychology" of people, as is shown by the long period during which Frenchmen went on counting in "old Francs". To replace our different national currencies by a European common currency would be much more difficult than the decimalization of sterling!! So during at leat several years, or even a decade, it will be necessary to allow the continued existence of the national currencies, in a declining role... while the European currency would be gradually more and more used , starting with intra-european and internation payments.

The first manifestation of this will must be action to give this currency its own identy. This will not only mean giving it a name-the best one found so far is "Europa" - but above all endowing it with characteristics enabling it effectively to fulfill the funcitons of a currency (unitof account, medium of exchange and store of value). The "Founding Father" of the Europa being here, I loose it gladly to him to comment further on it.

The institutional basis for the creation of the Europa has already been described in the report by the Commission of the European Communities presented to the Council on 30 June 1973, on which the latter has not yet taken a decision. In this report, the Commission proposed that the European Monetary Cooperation Fund, established in 1972 (to fulfill a very modest role which became further reduced as an increasing number of European currencies were floated independently), should be transformed into a kind o f European Bank responsible for the issue of European Monetary Units of Account" (EMUA) with which the central bank of member states of the Community would be credited against the gold reserves (and assets linked to gold) and dollars pooled, with the title thereto being transferred to the Fund.

In presenting its report, the Commission drew attention to one of the problems whose solution was a precondition for the implementation of the project. This is the definition of the unit of account, or more exactly, as stated above, of the link to be established between the new currency and the national currencies. Since it was proposed to issue the EMUA or Europas against pooled reserves and that these Europas should become the means of settlement between central banks for clearing the balances resulting from their market transactions, it was important to determine an equivalence ratio beetween the pooled reserves and the Europas and a conversion rate between the national currencies and the Europas.

At the same time, it would be possible for European countries to mobilize their gold by pooling it. Only on this condition will Europe's creditor countries - and especially the Arab countries - be

likely to invest their surplus funds in Europa- denominated issues floated by the European Fund itself or by the private sector.

As stated above, the question is not merely one of finding an equivalence ratio with a view to issuing Europas against European reserves and Arab investments ; an exchange rate relationship between the Europa and the national currencies of European countries and non-member countries (above all the dollar) must also be established, to make it possible to convert from one to the other before a sufficiently broad and diversified market has developed to allow the Europa to find its own exchange rate.

This relationaship cannot be established by determining a fixed price for the Europa in terms of gold, to which the national currencies would then be linked. Such a solution is desirable neither from the technical point of view (at what level should the gold price be fixed and for how long ?) nor from the economic point of view (the "commodity" currency system of which basing the Europa on gold would be a variant, belongs to an earlier stage in human evolution) nor, lastly, from the political point of view (an international consensus on the matter must be found and a number of countries or groups of countries are opposed). The most attractive solution, in the present circumstances, is to define the Europa in terms of what is sometimes called a "basket" or representative collection of European currencies. According to this method, all the European currencies would be grouped together in proportions yet to be defined; the resulting unit would constitute a Europa.

The objective to be attained with a view to progressing from the initial to the intermadiate stage in the Europa's existence will be to bring this currency to play a part in monetary relations between

Community countries - and possibly between the latter and other countries - analogous to that played by the dollar particularly where the latter currency's official function is concerned (intervention on exchange markets and reserve role) and that of the Eurodollar in the private sector. The structure contemplated would be as follows :

- The European Fund would be responsible for monetary policy in relation to the Europa and management of its exchange rate against the dollar;

- The central banks of member states would retain full authority over the monetary policy applicable to their own currencies and would be responsible for managing the exchange rates of their currencies against the Europa (and no longer gainst the dollar); until the end of this intermediate phase, the national monetary authorities would remain entirely free to determine the exchange rates of their currencies against the Europa, whether they decide - at least initially - in favour of a floating exchange rate, or whether, at a later stage, they confine the fluctuations of their currencies' exchange rates within a limited band (the "snake") intended to be narrowed progressively as economic and monetary union proceeds.

Not only should the public authorities be encouraged to use the Europa as an instrument od account, but it must establish itself as a unit in terms of which negotiable assets are denominated on the market.

The authorities could have recourse to the following measures :

- the issue of bonds denominated in Europas, by the Community's public institutions (ECSC, European Investment Bank);

In assessing the costs of an operation of this kind, it should not be forgotten that the development of a European "supranational" currency would enable European countries to lessen their dependance

on the dollar as the US currency would progressively be displaced by the Europa . Furthermore, one cannot exclude that the dollar could again be subject to upveals in the future, as a result of the development of inflationary pressures in the United States. In the meantime the European countries have developed a monetary sytem of their own based on Europas, they could avoid some of the "imported" disturbances they have experienced during recent years. We should not underestimate the difficulties of this enterprise, which in the same time point to weaknesses of the "snake" approach. Governments and central banks of some meber states are against any significant of reserves, if only because they keep a sizeable amount of their reserves in the form of gold. Also because they do not want some other countries to run permanent deficits with the European Monetary Fund, in the present political-economical framework of the Community.

Finally, I would again underline the political significance of monetary integration. In saying this, I do not so much take into consideration that fact that it is difficult for the European countries to develop economic and social policies of their own as long as their monetary relations are entirely based on the dollar. I am simply thinking of the fact that, whereas a monetary union can exist between countries keeping a large measure of political independance (cf. Ireland and the United Kingdom) a political union cannot be conceived without a monetary union. If we want to develop a European identity, and a true partner for Atlantic cooperation, we will need a monetary union.

The making of Europe is an endeavour fraught with uncertainity. European were less fortunate than Americans who succeeded in building their unity merely after one civil war. It tookthe Europeans many of them to realize that by continuing to wagewar they were bringing Euro-

pean civilization to the verge of total destruction. Half a century elapsed since Paul Valery issuedhis famous warning to his fellow Europeans : " We, civilizations, we know that we are mortal". Sometimes, it looks as if the warning has only been taken to heart for short periods of time. The Europeans should, I guess, ask to themselves the question whether Europe is not again proceeding through a dark period of scepticism, sef negation and despondecy.