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BACKGROUND NOTE

TARGET 1980: NO TURNING BACK
FOR EUROPEAN MONETARY UNION

In spite of or perhaps because of the recent international monetary crises, the European Community's goal of economic and monetary union by the end of the decade is running on course. At least, that's the conclusion of a recently released study by two European monetary experts.

Herman Wortmann, head of the EC Commission's monetary affairs division, and his principal administrator Florent Bonn base their conclusion on the progressively collective action taken by the individual EC member countries during the recurrent world monetary crises. Although written before the most recent international monetary turmoil, their thesis seems reinforced by the EC decision in the face of the February/March crisis for a joint currency float.

The Wortmann-Bonn study, entitled "The Theory and Practice of Monetary Integration in Europe," was published in the spring issue of Banking in Greater Europe (Das Bankwesen im Grösseren Europa, published by Nomos, of Baden-Baden, Germany).

The study talks of a twofold objective for monetary union: Internally, it would enable goods, services, people, and capital to circulate freely without structural or regional imbalances and distortions. Externally, toward the United States for instance, the Community would form a single and therefore effective unit in the international monetary system.

Without complete monetary union, the Community's internal common market will never function properly and fully, and the EC member countries individually lack the monetary weight to be more than pawns in the international money game with resultant undesired effects on their economies.

Although academics and theorists disagree on the optimum definition of monetary union and the optimal means of achieving it, most agree that the primary prerequisite for monetary integration is political will. Such will is often born from purely practical considerations.

High Employment Without Devaluation

Unilateral currency exchange adjustments by the EC member governments now more often fail than succeed in bringing stable economic conditions. Increasing fluctuations in currency values play havoc with international trade, on which Europe is much more dependent than, say, the United States or the Soviet Union. Currency fluctuations also have undesired effects on balance of payments structures, lead to high inflation rates, and weaken the international role of national currencies.

In addition, unilateral national action can have little effect on ever stronger multinational corporations, "hot money" flows, and Eurodollar operations.

To achieve high employment levels without devaluation or price stability without revaluation, common action is increasingly seen by the EC countries as the only practical solution. Hand in hand with monetary integration goes regional policy. The two compliment each other and reinforce the EC member states' political will toward both.

With complete monetary union, individual EC countries' balance of payments difficulties would appear in the form of regional imbalances. These imbalances would be mitigated by diverting income from more developed regions. In other words, taxes in depressed regions would be less than public expenditure. A single European currency -- or, at least, the nine national currencies linked irrevocably at immovable exchange rates, and freely convertible -- would make such a regional development policy feasible.

Monetary Integration To Date

The political will for a regional policy was expressed at the Paris "Summit" in October 1972 when the "Nine" set the end of 1973 as the deadline for the creation of a Regional Development Fund.

Also at the Summit, the Nine reaffirmed their determination to achieve complete economic and monetary union by 1980. Such a display of political will was preceded by nearly 15 years of discussion, proposals, and action.

Articles 104 and 109 of the Rome Treaty, which established the European Economic Community (EEC) in 1958, refer to the need for coordinating national monetary policies as required by economic circumstances. No concrete proposal was made, however, until 1962, when the Commission proposed that exchange rates be fixed to avoid disturbances in the common agricultural policy. The Council of Ministers failed to act on this program.

On May 8, 1964, the Council did act. It created a Committee of Central Bank Governors and a Budgetary Policy Committee. These committees facilitated joint monetary consultation. Moreover, the governments of the then six EC member states agreed to consult before altering currency parities. The international monetary crises of 1968-69 brought unilateral devaluation of the French franc and revaluation of the German mark, but not without prior consultations among the "Six."

On December 1-2, 1969, at the Hague Summit, the Six agreed on economic and monetary union as a goal of the Community. It would be gradually established along the lines of a Commission proposal -- the so-called Barre Plan -- through increased monetary cooperation.

Modeled on the Federal Reserve

On October 8, 1970, a Community-level committee of financial experts, headed by Luxembourg Finance Minister Pierre Werner, noted the incompleteness of the common market until monetary union was achieved. The Werner Group thus proposed a Community system of central banks, modeled in part after the US Federal Reserve System, together with an economic decision-making center responsible to the European Parliament. A first stage of three years toward monetary union would be launched on an experimental and pragmatic basis.

On March 22, 1971, the Council agreed to coordinate short-term and some long-term economic policies, to encourage more cooperation between EC central banks, and to create machinery for medium-term financial support. Most importantly, exchange rate margins between EC currencies would be progressively narrowed.

This Council action made it possible for the member states to adopt a common position in the international monetary system, thus facilitating the Smithsonian Agreement of December 18, 1971.

On October 20, 1972, at the conclusion of the Paris Summit, the Nine issued a communique which affirmed the "determination of the member states of the enlarged European Communities irreversibly to achieve economic and monetary union... The necessary decisions should be taken in the course of 1973 so as to allow the transition to the second stage of the economic and monetary union on January 1, 1974, and with a view to its completion not later than December 31, 1980."

On April 6, 1973, the key move was taken when the European Monetary Cooperation Fund began operations in Luxembourg.