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INFORMATION

ECONOMY AND FINANCE

THE ECONOMIC AND MONETARY UNION MAKES A FRESH START

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In February-March 1971, the European Community Council of Ministers made their decision to set up an Economic and Monetary Union. This was hailed by public opinion at the time as being a great date in the construction of Europe. Less than two months later, however, there broke out a monetary crisis as a result of which the experiment was badly compromised. In May, the influx of speculative capital led to the floating of the Mark and the Florin; and after the American measures of August 15, the same thing happened to the other Community currencies, with the solitary exception of the commercial French Franc. This made it impossible to continue with the progressive narrowing of the fluctuation margins between the Community currencies, which was an essential element in the plan for economic and monetary union. Progressively, however the feeling of solidarity and common interest among the Six Community countries bore fruit in a common front in international monetary discussions. This made possible the Washington agreement of December 18, leading to a general realignment of policies, including a devaluation of the dollar. This led to less disturbed conditions, and the Council, on a proposal by the Commission, made a fresh start with the Economic and Monetary Union on March 7 and March 21, 1972 with decisions :

- that the coordination of short-term economic policies between the governments of the member countries of the Community should be further improved ;
- that the maximum gap between the currencies of the Community should be restricted to 2.25 % by coordinated market intervention by the Central Banks of the Community countries ;
- that measures should be adopted to regulate the international flux of money and to neutralise its undesirable effects on internal liquidity ;
- that measures for regional development should be accelerated, especially by the application of appropriate financial resources.

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Reasons for an economic and monetary union

The formation of the economic and monetary union does not mean that a new organisation is being established. It represents a new stage, which is both necessary and logical, in the development of the European Community; and it is aimed at integrating the economies of the member countries, and creating a common European monetary system.

The Treaty of Rome leaves the responsibility for monetary policy in the hands of the Member States themselves, providing simply, that there shall be coordination at the Community level. Among its other provisions it does not go beyond considering policy in relation to rates of exchange -- and thus primarily the possibility of changes in the exchange parities of member currencies -- as a question of common interest.

Well before the crisis of May 1971, however, monetary events had made it clear that a common monetary policy was a necessity for the Community. In 1969, the devaluation of the French franc and the upward revaluation of the deutschmark had endangered the working of the agricultural market, which is based on common prices throughout the Community in terms of a European unit of account (equivalent to the pre-1971 American dollar). The principle of the agricultural Common Market could only be maintained by resort to measures of a transitional character.

The close links between economic policy and monetary policy make it impossible for the latter to be isolated and treated as a Community matter, so long as financial and economic policies are left within the entire responsibility of the individual member States. It is therefore necessary to find a common denominator for the economic objectives and policies of the different member countries.

The continued increase in the inter-penetration of the economices of member countries in the Community has in recent years had the effect of weakening the influence of national policies on business conditions, and reducing their scope. The Customs Union, for example, was brought to completion on July 1, 1968; and since this time the national governments have no longer been able to influence business conditions by changes in their customs tariffs, for action on these lines is now exclusively a Community matter.

Up to the present the Community institutions have had no extension of their powers in relation to business conditions and finance policy, to offset the limitation of the scope for action by individual governments. Thus, despite the medium-term economic programmes, which tend to produce a coordination of the national conjuncture policies, it has not been possible to fix concrete and mandatory common targets.

A joint economic and monetary policy has become increasingly necessary, not only as a means of safeguarding the progress the Community has already made, but also to facilitate its improvement and its extension in depth. The economic and monetary Union should facilitate the progressive formation of an organised and individual European monetary group, speaking with a single voice in international discussions and contributing to a better balance between Europe and the United States.

The objectives of economic and monetary union.

The objectives are set out in the Council resolution, approved in principle on February 9 and formally voted on March 22, 1971. The aim is defined as follows :

"In order to ensure a satisfactory rate of growth concurrently with full employment and stability within the Community, to remedy the structural and regional imbalances which are to be found there, and to reinforce the contribution of the Community to international economic and monetary cooperation, and thus to attain a community of stability and growth, the Council and the representatives of the governments of member States express their political will to set up during the next ten years an economic and monetary Union under a plan providing for successive stages beginning from January 1, 1971".

It was envisaged that the many measures to be taken in forming the economic and monetary Union should result, by the end of the seventies, in the Community attaining the following objectives :

"1. Becoming a zone inside which, persons, goods, serices and capital will circulate freely and without distorsion of competition, but without setting up structural and regional imbalances and in conditions which will enable businesses to expand their activity on the Community scale ;

2. Becoming, within the international monetary system, an individual monetary group characterised by the complete and irreversible convertibility of currencies, the elimination of margins of fluctuation between the exchange rates and the irrevocable fixing of relationship between the currency parities which are regarded as the indispensable conditions for the creation of a single currency, and which will involve an organisation of the Central Banks on a Community basis ;

3. Being vested in the economic and monetary field with powers and responsibilities which will enable its institutions to conduct the management of the union. For this purpose, the necessary decisions of economic policy will be taken at the Community level, and the necessary powers will be vested in the institutions of the Community".

The objectives of the economic and monetary Union are thus on an ambitious scale; but the Council of Ministers, on February 9, 1971, expressed its conviction that the final target can be reached, provided it has "the permanent support of the governments". The history of the Community, indeed, shows that when the governments of the member countries have the political will to take action, it is always possible to find the necessary solutions for the economic problems arising.

The final objective of the economic and monetary Union cannot be reached by the immediate creation of a European currency. It is easy to understand that, for psychological and political reasons, it is desirable for a Community currency to come into existence as quickly as possible. Its creation, nevertheless, must necessarily be the crowning event in a process in which the margins of fluctuation and variations in exchange rates between the currencies of the member countries become progressively smaller and smaller, until they have been fully and finally eliminated, so that the ultimate result is complete and irrevocable inter-changeability between the currencies of the member countries, between which changes of parity can no longer happen.

The plan for economic and monetary Union also provides that the monetary policies of the member countries will be more closely harmonised, and that the Community will ultimately have only a single monetary policy. Only when these objectives have been attained and a European central bank has been formed, will it be possible to replace the national currencies by a single Community currency.

Economic and monetary Union also means that the more important decisions of economic policy will,on the long term be taken at the Community level. Powers which are now still concentrated at the national level will therefore have to be transferred to a large extent to the European Community level. The transfer of responsibility in matters of economic and monetary policy,from the national governments to the institutions of the Community, is a step of great political significance.

Moreover, the resolution of February 9,1971 lays it down that the Community institutions must be put in a position to exercise their economic and monetary responsibilities "efficiently and quickly"; and that the European Parliament must be empowered to supervise the Community policies brought into effect under the economic and monetary Union. All this implies the necessity for various institutional reforms. Before May 1,1973 the Commission is to submit a report to the Council about this.

The Community and the international monetary crisis

Monetary difficulties — resulting from the American inflation and its effect in inducing speculation — began during the sixties. The European Community, by setting up a Monetary Committee and a Committee of Governors of Central Banks, was taking the first steps towards a coordinated policy for the Six countries. A memorandum by the Commission in February 1969 was the first general attempt to treat monetary problems and economic problems in parallel. It called for concerted medium-term economic policies,and the coordination of short-term economic policies; and in order to mitigate balance of payments difficulties, it proposed setting up a system of short-term monetary support and a system of medium-term financial aid. After the 1969 devaluation of the French franc and re-valuation of the deutschmark, the Summit conference at the Hague (December 1969) took the decision that the Economic and Monetary Union should be formed. The resolution and the Council decisions of February/March 1971 provide for the following measures :

Monetary measures. This is essentially a matter of coordinating policies and studying the possible formation of a European monetary cooperation Fund,which would make it possible to keep the fluctuations in exchange rates between

Community currencies within a narrower margin than would result from the permitted margins in relation to the U.S. dollar. In international monetary policy, it is also a matter of defining a common policy for the Community countries in the various international monetary bodies, especially the International Monetary Fund.

Economic measures. This is essentially a matter of attempts to coordinate short-term policies by improved consultation procedures and specific measures to co-ordinate policies in relation to finance markets,harmonising conditions surr-ounding the issue of securities, and adopting harmonisation measures for various taxes,such as A.V.T., excise duties,company taxation and conditions affecting movements of capital.

Closer coordination of short-term economic policies between member countries. It is envisaged there shall be three regular sessions of the Council for this purpose. The first,during the first quarter of each year, will be devoted to an examination of the policy followed during the preceding year,and seeking to adapt policy for the current year to the requirements of economic changes. The second session would lay down the policy to be followed,and define compatible trends for the economic budgets and quantitative orientations for the public budgets of the following year. In the third session the Council,voting on a proposal by the Commission and after having consulted the European Parliament, would finalise an annual report on the economic position of the Community,from which it would be possible to fix the line of policy to be followed by each member country during the following year. This report would be communicated to the different governments and to the national parliaments.

Closer collaboration between central banks. It is envisaged that the Committee of Governors of Central Banks should be the organ for coordinating currency and credit policies,with a concerted approach to the development of banking liquidity, conditions for credit distribution and the level of interest rates.

The project for economic and monetary Union was,however, severely shaken by the serious international monetary disturbances at the beginning of May 1971, which resulted in the floating of the mark and the florin. In addition, the American measures of August 15, by which the convertibility of the dollar was suspended, a tax surcharge imposed on imports and other protectionist measures taken,resulted in further aggravation of the international monetary situation.

At this juncture, the Council and the Commission continuously made their best efforts to bring the international monetary position back to normal. Throughout the meetings of the Group of Ten (1) it was possible to define and defend a joint position for the Six member countries. This common,front which had support from the start by Great Britain,facilitated the decisions taken in Washington on December 18.These included a 7.89 % devaluation of the dollar against gold; a devaluation of 1 % in the Italian lire and the Swedish Crown; an upward re-valuation of 7.66 % in the yen,4.61 % in the deutschmark and Swiss franc and 2.76 % in the Belgian franc and the Dutch florin,while the British pound and the French franc remained unchanged. New permitted margins of fluctuations were, however, adopted. These were now to be 2.25 % above or below the new parity of the dollar, a much wider margin than was laid down in Bretton Woods (± 1 %) or by the signatores to the European monetary agreement (± 0.75%). At the same time the American protectionist measures of August 15 werewithdrawn. This set up a new situation,in which the Commission deemed it opportune in relation to currency matters, to submit a further communication to the Council which was dated January 12,1972,defining three essential points contained in the resolution of February 1971 :

1) As regards the narrowing of the permitted margins of fluctuation of the Community currencies in relation to one another,the Commission proposed that the maximum gap should not exceed 2 %. The Washington agreement authorising fluctuations on either side of the dollar of as much as 2.25 %, would permit of a gap between individual Community currencies of as much as 4.5 %,or even 9 % if two Community currencies should move in opposite directions from the floor to the ceiling in relation to the dollar. The fact of allowing Community currencies to undergo fluctuations on this scale might well mitigate or even abolish the effect of the removal of customs duties inside the Community, which had been carried out in successive stages since 1958. The effect of limiting the permitted gap to 2 % is not only to avoid this inconvenience, but to conform to the principle of narrower margins adopted in 1971, and give the Community a monetary individuality in the international currency set-up.

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(1) The Group of Ten consists of the United States, Canada,Japan,Great Britain and the five countries of the Community.

2) As regards intervention in the foreign exchange markets in Community currencies, it would be the task of the Governors of central banks to keep the Community currencies within the 2% band and to supervise the movements of this 2 % band within the 4.5 % margin around the dollar. In doing this it would be incumbant upon them to define the main lines of their intervention policy. They would also have to fix the arrangements for the holding of Community currencies, along with other instruments of reserve, as part of the monetary reserves of each of the central banks. The creation of the European monetary cooperation Fund would facilitate the coordination of market operations and the harmonisation of the reserve policies.

3) On the question of dealing with speculative capital movements, the Commission restated its proposals of June 1971 indicating four lines of action:-

- the regulation of use of currency market balances and the remuneration of the deposits of non-residents;
- the regulation of loans contracted abroad by residents;
- the regulation of the net external position of credit institutions;
- the fixing of compulsory reserve ratios, especially in relation to the assets of non-residents.

After discussion in the Council, at its meeting on January 31 and February 1, the Commission drew up a conspectus of the conditions for carrying through the first stage of the economic and monetary Union. In doing this, the Commission did not confine itself to a summary of what had been achieved, what had been neglected and what remained to be done; but it suggested improvements inthe parallel development of monetary unification and the convergence of economic policies. It then issued, under date of March 1, a summary document intended to aid the deliberations of the Council. This was in the form of a draft resolution, as setting out the measures which would have to be taken in the co-ordination of economic and monetary policies and in relation to structural and regional action. The draft took into account the latest developments in the general position and the suggestions made by the German delegation to the Council in regard to the formation of conjunctural policy co-ordination group and the desirability of issuing a directive aimed to promote stability, growth and full employment in thenCommunity. In relation to the narrowing of the currency fluctuation margins, the Commission agreed that the gap at any time between the highest and lowest quoted of the Community currencies should not exceed 2.25% with the further aim of bringing the margin as quickly as possible down to 1.50% and always with the longer-term objective of eliminating fluctuations between

Community currencies altogether. It also asked the Council to state its view on the formation of the European monetary co-operation Fund; and on the the need for a report aimed not only at defining the organisation of this Fund, but also of laying down the conditions in which the unit of account might come progressively to be used as an instrument of intervention in the foreign exchange markets, and in financial relationships between one Community country and another. In addition, the Commission pressed for the adoption of its draft directive of June 1971 for dealing with the influx of speculative capital and the measures proposed in May 1971 in regional and structural matters.

The decisions of March 7 and March 21 1972

The Finance Ministers made a first survey of these proposals on March 6 and 7. On March 21, it formally adopted the resolution which had been put forward by the Finance Ministers. In large measure, this amounted to the adoption of the proposals made by the Commission:-

1) As regards the co-ordination of short term economic policies, the Council set up a conjunctural policy co-ordination group. This consists of a single special representative from the ministry or ministries concerned in each of the member countries, together with Commission. When any member country contemplates measures departing from the lines of economic policy laid down by the Council, the group is immediately informed for purposes of an advance consultation. For Council sessions devoted to the co-ordination of economic policies, it works together with the Committee of Permanent Representatives. The Commission is mandated to submit to Council a draft directive aimed at the promotion of stability, growth and full employment within the Community.

2) The European and Agricultural Guidance and Guarantee Fund (EAGGF) may be brought into use as from 1972 for purposes of regional development; but an alternative has been put forward of forming a regional development fund in the form of some other system of appropriate Community ressources.

3) As regards the narrowing of fluctuation margins between Community currencies, the procedures adopted by the central banks should be tested in an experimental phase; and as from the time it is brought into operation, the gap between these currencies may no longer be made wider. As from July 1 1972, the maximum gap must not exceed 2.25%; and the irreversible target is still the elimination of any fluctuation margin. The intervention of central banks in the foreign currency markets will be in Community currencies if the rates for these should reach the maximum limit of flucuation permitted between Community currencies;

and in dollars if the rate for the currencies concerned reaches the limit of the maximum fluctuation authorised by the Washington decisions of December 18. Settlements of balances between central banks arising from operations in Community currencies will, in principle, be carried out within an interval of one month; and the mode of settlement will depend on the structure of the monetary reserves of the debtor country.

By June 30 1972, the monetary Committee and the Committee of governers of central banks will put forward a report on the organisation, functions and rules of a European monetary co-operation Fund.

The Commission's draft directive of June 23, 1971, providing for the regulation of international monetary flows and the neutralisation of their undesirable effects on internal liquidity, was duly adopted.

4) The proposals put forward by the Commission regarding the completion of the first stage of economic and monetary Union and more especially those relating to fiscal harmonisation and the progressive development of the European capital market were given a priority ranking on the Council agenda. The Council will make its decision on these proposals within six months from the date of their entry on its agenda.

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