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Two members of the staff of the European Commission have made an important contribution to the study of monetary integration problems,and to those connected with the initiation and prospects of the future economic and monetary Union. It is entitled "The Theory and Practice of Monetary Integration in Europe"; and the authors are Mr. Herman WORTMANN and Mr. Florent BONN respectively the head and the principal administrator in the International Monetary Problems division of the Commission.

Their work is to be published in the spring of 1973 in "Das Bankwesen im grösseren Europa" (Banking in Greater Europe) compiled by Professor Rudolf REGUL of Baden-Baden and Mr. Herbert WOLF of the Commerzbank,Fränkfurt a/M and published by "Nomos" of Baden-Baden. This note comprises a summary of the Wortmann-Bonn contribution.

On January 1,1973 a new page was turned in the history of Europe's integration, when the European Community was enlarged considerably by the admission of three new members,Denmark,Ireland and the United Kingdom.

Since the European Communities were first formed Europe has passed through several important stages in its integration,all of them making for closer co-operation between the members in all economic fields. The most significant landmarks were the completion of the Customs Union and the entry into force of a joint agricultural policy.

The problem of economic and monetary union came later. Opinions inside the Community had long advocated monetary union; but the decisive push came from the meeting of heads of State and governments at the Hague on December 1 and 2,1969. It was confirmed by the resolution of the Summit meeting in Paris on October 19 and 20,1972.

On the monetary side,the top political decisions taken at the Hague, led to the Council resolutions of March 22,1971 and March 21,1972,the latter of which was adopted with the full consent of the future new members. These resolutions were a major step towards the stage-by-stage formation of the economic and monetary union of the Community countries and led naturally to the Paris Summit, by which they were expressly confirmed.

In the first part of this article we shall consider the theoretical side of monetary union in Europe; and the second will be devoted to the practical side of monetary integration in the European Community.

I. THEORETICAL CONSIDERATIONS ON MONETARY UNION IN EUROPE

Monetary cooperation between a number of countries -- in the present case the countries of the European Community -- may take several forms. The most advanced form of monetary integration is monetary union in which all the national currencies disappear and are replaced by a common european currency. It is also possible to think in terms of a de facto situation which will be much the same in practice,but in which the national currencies would still co-exist. In this case they would be irrevocably linked together,because all the member States would have undertaken to provide unlimited convertibility at fixed rates of exchange between their different currencies.

The ultimate objective of monetary union is two-fold. Internally it constitutes an interior zone in which goods and services, people and capital can circulate freely without distorsions of competition and without setting up structural or regional imbalances. Externally the Community would form an individual and organised monetary unit. As the Community progresses towards monetary union it is desirable that it should impress the mark of its individuality on the international monetary system.

1. Conditions for monetary integration : Is Europe an optimum monetary area ?

The fixing of irrevocable exchange rates between the currencies of the Community countries raises the question of what is lost and what is gained by the member States in giving up their sovereign right over the rate of exchange. The various Community countries have, and will probably continue to have, different Phillips curves -- i.e. they have discrepancies in their combinations of the rate of inflation and the rate of unemployment -- because their preferences regarding the most appropriate price/employment combination are different.

Admittedly, so long as there exists a money illusion, the member States need only possess control of the exchange rate as an instrument by which they can substitute devaluation for unemployment when there is a deficit, and revaluation for inflation when there is a surplus. In practice the change in the fixed exchange parities, or the existence of a system of fluctuating rates, is only opportune if it leads to a variation in the real level of wages which could not be brought directly into effect by an adjustment in their nominal rates. The concept of an "optimum currency area" is introduced in seeking for this condition, which is necessary for the effectiveness of a change in the parity relationships between members of a group of countries.

Many approaches have been suggested. Mundell has emphasised that fluctuating rates between nation States do not in general make it possible to reach internal and external balance at the same time. On the other hand, fluctuating rates between optimum monetary areas (inside which the rates of exchange are fixed) make it possible for each area to establish its external balance (balance of payments) and its internal balance (market equilibrium for goods and services; price stability; balanced conditions in the employment market; a high level of employment). Mundell attempted to identify the criterion for an optimum currency area, with the mobility of the factors of production -- great mobility within the area and a high degree of immobility outside it. Since the economic and monetary union of Europe is in fact characterised by this type of factor-mobility, there is a temptation to conclude that this union is in fact an optimum currency area.

Other theorists, such as Mc Kinnon, consider rather that the optimum currency area is a function of the degree to which the economy is open, as represented by the relationship between "tradeable" and "non-tradeable" goods, and thus the degree of autonomy in the area concerned in the determination of the general level of prices. It is in fact true that the more open an economy may be, the less is the capacity of national authorities to act freely in determining the level of prices. In Luxembourg, for example, since 80 % of consumer expenditure is on articles of external trade (the prices of which increase after a devaluation) it is not probable that wages can be diminished by devaluation, since their subsequent fixing will be such that the real level will not be reduced and the devaluation would quickly become ineffective. The adjustment will thus have to be made through internal policy, which will have considerable impact on imports and exports, but comparatively little effect on the internal movements in prices and wages, simply because there is a close relationship between "tradeable" and "non-tradeable" goods.

Various other theories have been put forward in the same field. Kenen, for example, considers the Mundell thesis (mobility of the factors of production) and Mc Kinnon ("moneyness" of the currency of the area), to be insufficient, and seeks the real characteristic of an optimum currency area in the diversity and flexibility of economic activity. When the activities of an economic system are very diverse and if it is able to adapt itself quickly to competitive conditions, it is in a position to absorb the after effects of adjustments in commercial relationships with other countries. In such conditions stable rates of exchange inside the area are the best guarantee of diversified development in production and trade. The criterion suggested by Kenen is in fact contradictory to that of Mc Kinnon; for when activities become increasingly diversified the relationship between "tradeable" and "non-tradeable" goods normally tends to diminish.

Searching discussions have been carried on for years between the theorists and between them and those in charge of monetary integration in practice; but it has not yet been possible to reach a consensus of opinion on the validity of the above theories,or their application. It is still doubtful indeed whether an external equilibirium resulting from fluctuating exchange rates always makes it possible to secure internal balance. Moreover, fluctuating rates do not necessarily lead to the desired structure in the balance of payments. Powerful arguments can indeed be adduced to the effect that fluctuating rates lead to a greater degree of inflation and boost the process of replacing national currencies by primary international currency -- the dollar. In general the impact of exchange rate policy on internal and external economic development seems sometimes to be underestimated. Inflation,education in economics and the spread of knowledge regarding changes in rates of exchange,are all factors conducing to a considerable diminution of the money illusion.

However this may be, none of the criteria put forward make it possible to decide a priori whether any given group of countries could or should form a unified monetary area. In the policy of integration,therefore, it is not any specific conception which appears as the most convincing,but rather the political will to proceed towards monetary integration. This seems reasonable enough,for it adds a discretionary element of political content to the automatic elements emphasised by the theorists above mentioned in the process of adjustment inside the area concerned. In consequence the Commission,and the other Community institutions, in determining whether the economic conditions for monetary union are being progressively satisfied, base their opinion essentially on the political will of the member countries to commit themselves to the convergence of the objectives of their economic policies.

Both in politics and in practice,the question regarding the european monetary area is not whether it is optimum,but whether it is practicable. This is a question of whether one can choose a point on the Phillips curve which -- in virtue and consequence of the desire to come into a monetary area -- may be different from the point one would otherwise have chosen. It is thus a question of political notions which must not be confused with the idea of theoretical optimum.

The "trade-off" between the inflation accepted and the employment level sought has been chosen in the medium-term economic programme in such a way as to constitute a group of objectives which can be expressed in quantitative terms and are compatible among themselves. It is indeed possible that one or more countries may not find themselves on that point of the Phillips curve which they would have chosen; but one may nevertheless ask whether,if there had not been Community commitments all round, the national authorities would really be in a position to reach the points they would have chosen. The experience of recent years has shown that countries are barely in a position to attain the objectives they fixed for themselves. Even the German revaluations of 1969 and 1971 did not reestablish the internal balance which was,nevertheless, their main pretext and target. In the same way,the devaluation of the British pound on November 18,1967,does not seem to have taken place in suitable conditions and the money illusion seems to have been virtually absent.

It thus seems that the pursuit of the integration policy,as defined in the attitudes of Community authorities, is acceptable even to such a theorist as Professor Johnson who,though he advocates fluctuating exchange rates, nevertheless concludes : "it seems to me that actual experience of exchange rate problems strongly supports Haberler's emphasis on harmony or discord of national demand management policies as the crucial consideration "(1)

The formation of a european monetary area would probably contribute to the coming into existence of an international monetary system in a world consisting of a limited number of units of unequal economic dimension,each of which would have a more or less independent power of decision in monetary matters. Such a system would materially ease the difficulties inherent in the adjustment problem.

2. Monetary integration as a political process : convergence of economic and monetary policies and subsequent centralisation.

If there is to be balanced economic development among the countries of the Community,the objectives of the economic policies in the different member countries must be mutually compatible; and political decisions must be taken, both at the national and at the Community level,to ensure the continuous conformity of economic development to the objectives which have been fixed in common.

The analysis of this problem has raised lively discussions, the most important elements of which are :

- the principles of paralellism and progressivity ;
- the degree of centralisation of decision-making in the monetary, budgetary and regional fields ;
- the political organisation of the Community.

Parallelism implies simultaneous progress on three fronts -- economic policy, monetary policy and institutions. There was keen controversy as to the adequate degree of progress to be obtained in these different fields. They were discussed in depth in 1970, when the Werner report was compiled; and it does not seem necessary to go over the ground again in this article. In general, the action in the different fields must be considered as being complementary and necessary. The process towards monetary union is such as to require deep-seated changes in every field of economic policy, because it has its influence on each country's macro-economic development.

Progressivity is the proclaimed choice of those who argue that "natura non facit saltus". The principle, nevertheless, seems to be inspired by conditions of practice and policy rather than of theory. On the other hand, and perhaps as the result of crises, there might be dramatic action in some particular field -- whether it be monetary, economic or political --and this might act as a catalyst in monetary integration. With this in view the suggestion has been made that an account unit should be set up, and should progressively take over the functions of a currency before the parities with it of the national currencies are irrevocably fixed.

The degree of centralisation of political decisions depends, to a large extent, on the degree of harmony sought in short and medium-term development of Community countries.

In general, it will be in the monetary field that centralisation will take its most advanced form. In the final stage it will no longer be possible to carry out an independent national liquidity policy; and the monetary area will be seen from outside as a single unit. Even during the integration process the degree of independence of national monetary policies -- both internally and more especially, externally -- will be very limited. On the other hand the essentials of budget policy will still lie within the competence of the national authorities. Admittedly the macro-economic impact of budget policy,which results primarily from the scale of the surplus or deficit, and the manner of its financing,and from changes in the general level of expenditure and receipts,will have to be settled at the Community level. Moreover, a Community budget on a more or less important scale,not only means that decisions will be centralised,but also that the expenditure and receipts themselves will be within the direct function of the Community bodies. Perhaps, too, it will be necessary to require certain commitments regarding the general composition of the receipts and expenditure.

It is interesting to note that in the United States,which is undoubtedly a monetary union, the proportion of federal government expenditure is only about 60 % of the total expenditure of public administration (federal,State and local). Despite the potential importance of local authority receipts and expenditure, it appears that these are not in fact subject to considerable variations which might materially affect business conditions. In practice, there are a number of factors which limit the scope of local authorities in their budget management. Their taxation powers are not of a strongly progressive character; and their scope for increasing their indebtedness in the money and finance markets is limited by various institutional and psychological factors.

On the question of how far there should be an active regional policy, it must be borne in mind that at the end of the monetary integration process,the balance of payments difficulties of the individual Community countries will appear in the form of regional imbalances. So far as possible, these equilibia will have to be mitigated through automatic mechanisms which will divert the incomes of the richer and more dynamic regions into those which are at a comparative disadvantage.

The fixed rates of exchange and the freedom of capital movements should be rounded off by an integrated financial system which is the only way of enabling financial resources to be transferred between deficit regions and individuals residing elsewhere. If such a system is to work properly,it is necessary for there to be a large mass of financial instruments acceptable for payments throughout the monetary area. This could be achieved by developing the different forms of financial instrument expressed in terms of european units of account,and the scale of which considerably exceeds the exchange reserves of the central banks. If there is a sufficient volume of private negotiable instruments in the various parts of the monetary area, the proportion of the ultimate settlements required to be handled by the central banks would be the smaller.

In regions which are in depression or structural decline, the amount of taxes paid must be less than the public expenditure. This must be achieved through an automatic fiscal mechanism,or as the result of a conscious act of regional policy. The resulting transfers will serve both,for recovery in the depressed area,and for the settlement of inter-regional payments balances. Economic and monetary union is thus more difficult to operate than a national State,because there is no (progressive) european tax on incomes.

Apart from these automatic financial offsets, a deliberate regional policy would need both to coordinate the regional action taken by the national authorities and to possess various instruments by which it can strengthen the Community character of the regional policy. In this connection,it may be emphasised that, even if there are no legal instruments to secure a more balanced geographical spread of economic activity,there will be a spontaneous growth of political pressure to iron out the differences in standards of living in the various Community regions.

II. MONETARY INTEGRATION IN PRACTICE

Increased inter-penetration of the national economies has weakened the scope of national economic policies without offsetting the loss of national capacity by a counterpart growth of Community policies. This has brought to the surface the insufficiency and imbalance of the process of creating the Common Market.

The short-comings which have thus appeared,have been dealt with by agents in different parts of the economy in their self-adaptation to the new market conditions. This explains the development of multi-national firms,the euro-currency markets and the euro-issues of bonds. There has,too, been a considerable growth in the movements of hot money. These developments tend to make it even more difficult for the member countries themselves to master their economic development; and the increasingly close inter-dependence between the national economies raises with growing clarity the problem of a common monetary policy. This,however, is dealt with only in summary fashion in the constitutive Treaty of the E.E.C. (Article 104 and 109). At the present time monetary cooperation within the Community, is based essentially on these provisions, the Commission memoranda of October 24, 1962 and February 12,1969,the Council decisions of May 8,1964 and July 17,1969 and on the measures taken under the Council resolutions of March 22,1971 and March 21,1972 on the stage-by-stage formation of an economic and monetary union.

1. The E.E.C. Treaty and the first Community actions

a) The E.E.C. Treaty

The monetary provisions of the E.E.C. Treaty are of rather a general character. The necessity for monetary coordination is in fact considered by reference to economic requirements; and the provisions themselves are of only a limited scope. Since the E.E.C. Treaty came into force, Articles 104-109 have been the basis for Community action to define the methods of monetary cooperation, and adapted to the progress of economic integration in other fields.

b) The first Community action

The Commission memorandum of October 24,1962,on its action programme in the second stage of the Common Market (2) contains a chapter on monetary policy, in which the broad lines are sketched out. The Commission takes the view that it would be necessary to have fixed exchange rates inside the Community, if it is sought to avoid serious disturbances in the joint agriculture policy; and it states that,if there should be changes in the parities "the Common Market itself might be endangered".This programme was not brought into force and was not even thoroughly discussed.

The first organised monetary cooperation by the Community,on the basis of the Treaty provisions, is embodied in three decisions and a joint declaration by the Council under date of May 8,1964.

A committee of the governors of central banks was set up (3). Its mandate was essentially to hold consultations relating to the general underlying principles and the main lines of policy of the central banks,more particularly in matters of credit,the money market and foreign exchange.

A budget policy committee was also set up (4). Its task was to examine and compare the main lines of budget policy in the member countries, on account of the fact that budget decisions have an important influence on the development of business conditions and in the monetary field.

An obligation to cover consultation in advance, to operate through the monetary committee, is imposed on the national governments, so that there may be close coordination between the policies of the member States in matters of international monetary relationships (5). The governments declared their intent to consult one another in advance of any change in their currency parities (6).

2. The Commission memorandum of February 12,1969.

The insufficiency of monetary policy, as conceived in 1964, was to be made abundantly clear by the crisis of November 1968. The French government reintroduced exchange control on November 24,1968 ; and this was followed by the devaluation of the French franc by 11.1 % on August 8,1969 and the upward revaluation of the DM by 9.3 % on October 24,1969.

Not only did the currency crisis show up the holes in existing monetary policy; but it also led to divergence within the Community, and the solidarity between the member countries was seen to be insufficient. The affect of the crisis was to demonstrate the need for a real joint monetary policy, and this led to the submission to the Council of the Commission memorandum of February 12,1969 (7), known as the "Barre Plan" after the Vice President of the Commission who was principally responsible for its content.

The "Barre Plan" appears as the primary driving force in the movement towards monetary integration. It specifies measures to be taken for harmonising economic policies and measures for mutual aid in the monetary field. It is conceived primarily in terms of the need for a certain parallelism between the progress in coordinating economic policies and the practical emergence of monetary solidarity between the member countries :

a) In regard to economic policies, it calls in the first place for an obligation to consult in advance of any short-term political decision which may have a material impact on the economies of the other member States and representing a departure from the medium-term objectives which have been defined in common. It contains, however, a safeguard clause exempting the member States from the preliminary character of these consultations if circumstances should so require (8); the other proposal is that there should be an examination and definition, in quantitative terms, of the medium-term policy objectives, both of the Community and of the member States over the 1971-75 period.

b) On the question of monetary solidarity, the "Barre Plan" calls for the working out :
   - of a system of short-term monetary support between the member banks (9) which was in fact decided upon a year later (1970);
   - a system of medium-term financial support (10) which was decided upon two years later (1971). This provides machinery for the granting of mutual support in the form of financial assistance under a sufficiently quick procedure, to a member country experiencing difficulty in its balance of payments.

It was at the top political level that fresh impulse was given to the monetary integration drive. In the final act of the conference of heads of State and governments at the Hague on December 1 and 2, 1969, it is expressly provided that a plan shall be worked out during 1970 for the stage-by-stage achievement of economic and monetary union "on the basis of the memorandum submitted by the Commission on February 12, 1969 and in close cooperation with the Commission".

3. The Commission communication of March 4, 1970

As a contribution to the working out of this plan, the Commission put forward a communication to the Council (11) giving its ideas on the principles which it considered should be taken into account and the main lines of the different stages which it thought should be fixed in reaching economic and monetary union.

The Commission considered that the action to be taken for creating an economic and monetary union should be accompanied by a strengthening of the Community institutions in economic and financial matters. As the different stages of the plan were carried out, it would be necessary to improve and complete instruments so as to prepare for a final stage in which there would be assigned to Community institutions all the powers required for the right functioning of economic and monetary union.

4. Other plans for the stages on the way to economic and monetary union

During the early months of 1970 several authorities and leading personalities suggested their own version of plans for the different stages. Outstanding among these were the Schiller plan, the Werner plan and the Belgian plan.

All the plans agreed in broad terms regarding the objectives sought, and accepted the idea of the transfer of responsibility from the national to the Community level. In general, too, they considered it should be possible to reach the objective within a decade. The different plans, however, show a basic divergence of approach between those known as the "monetarists" and the "economists". The former emphasise the need for action in the monetary field, even without any increased convergence in economic policies; and the second consider that such action would be dangerous if there is no corresponding progress towards the coordination of economic policies and/or the strengthening of the Community institutions.

5. Final report of the Werner group and report of the Ansiaux expert committee of October 8,1970.

a) Final report of the Werner group (12)

The Werner group emphasised the insufficiency and incompleteness of the Common Market and proceeded to define the basic elements for the existance of a full economic and monetary union. This objective would imply a considerable transfer of responsibilities from the national to the Community level; and its achievement would make it necessary to create two organs :

- a centre of decision for economic policy, which would act independently in function of the interests of the Community, and the influence of which on the Community's general policy would be decisive. It would be politically responsible to the European Parliament, the powers of which would be enlarged; and this would involve a simultaneous change in the method of election of its members;
- a Community system of central banks, which might be modelled on organisations such as the Federal Reserve system in the United Statess. This Community institution would be empowered to take decisions of a monetary character.

The first stage of monetary union should begin on January 1,1971 and continue for three years. One of the essential objectives to be reached in the 1971-73 period,would be the joint definition of the fundamental orientations of economic and monetary policy. For this purpose the Council would make at least three thorough surveys of the economic situation of the Community. The Committee of Central Bank Governors would play an increasingly important part in dealing with all problems of monetary policy. In addition procedures for concerted approach would be laid down between the Commission and the social partners.

The second stage would be marked by the continuation of the action set in motion in 1971-73,but in increasingly compulsive forms. The strengthening of the monetary links inside the Community should be reflected as soon as possible in the formation of a european monetary cooperation fund, which would foreshadow the Community system of central banks,as it would exist in the final stage. The fund could,if the possibility should arise, be established during the first stage of the union.

b) Report of the Ansiaux expert committee

The experts took the view in their report (13) that a first step towards an exchange system specific to the Community,should consist in the central banks acting concertedly in a de facto limitation of the fluctuations between their own currencies inside a narrower margin of permitted fluctuation than those laid down for the dollar at the time the system is introduced. The objective should be reached by concerted operations on the dollar. In a second phase an announcement would be made of the reduction in the margins,and there would be further concerted action on the dollar which might be completed by intervention in Community currencies at the limit of the permitted margins. At a later stage there might be concerted action on the dollar and intervention in Community currencies,both at the limit and inside the permitted margins.

Monetary events in 1971 changed the fundamental basis of the problem; and the Committee of Central Bank Governors accordingly re-examined the analysis and conclusions of the Ansiaux report to allow for the new facts. These had included new central exchange rates,the inconvertibility of the dollar,the widening to 2.25 % either side of parity of the permitted fluctuation margins of the central exchange rates and the expected participation of the prospective new members of the Community in the machinery for narrowing the margins.

6. Resolution and three decisions by the Council of March 22,1971

When the Council met on March 22,1971 it adopted a resolution and three decisions which were essentially based on proposals submitted by the Commission on October 29,1970 (14).

a) Resolution by the Council and the representatives of the governments of member States on the achievement of economic and monetary union (15).

This text records the political will of the member States to create an economic and monetary union,in conformity with a stage-by-stage plan to be initiated as from January 1,1971. To this end the resolution lays down that the division of competences and responsibilities between the Community institutions on the one side and the member States on the other, should be determined in function of what is necessary for the cohesion of the union and the effectiveness of Community action. A Community institution of central banks should,within the framework of its own responsibilities, provide support for the achievement of the Community objectives of stability and growth.

The resolution also includes a number of provisions relating to the carrying through of the first stage which should run from January 1,1971 to December 31,1973.

b) Three Council decisions of March 22,1971

The Council decision on strengthening the coordination of short-term economic policies (16) provides that the Council should sit three times each year for the examination of the economic situation of the Community; and that on these occasions it should determine the short-term economic policy orientations on the basis of a communication from the Commission containing,if necessary,draft decisions,directives or recommendations.

In the decision covering increased cooperation between the central banks (17) the Council invites them to coordinate their policies in monetary and credit matters through the sittings of the Committee of Governors; and to lay down the general lines of conduct for each of them regarding bank liquidity,conditions for the availability of credit and the level of interest rates.

Following proposals made by the Commission in its memorandum of February 12,1969,the Council also adopted a decision recording its agreement on the formation of machinery for medium-term financial support mentioned in section 2 above.

The Council also adopted the third medium-term economic policy programme (18). The policy orientations in this are given in figures,and thus constitute a framework in which the coordination of economic policies can contribute to a higher degree of convergence in the economic development of the member countries. The resolution of March 22,1971 makes several references to this,more especially in relation to the priority actions to be undertaken, structurally and regionally, and the consideration to be given to the medium-term policy objectives in the coordination of the short-term economic policies.

The resolution and the three decisions of March 22,1971 had been greeted as a major landmark in the construction of Europe. Less than two months afterwards,however, there broke out an international monetary crisis,which was to interfere seriously with this experiment. The currencies of the Six member countries of the Community reacted to the crisis in different ways. In May the influx of speculative capital into Europe led to the floating of the deutschmark and the Dutch florin; and after the American measures of August 15,the same thing happened to the other Community currencies,with the exception of the official market for the French franc. The progressive contraction in the margins of fluctuation between the Community currencies, which was the essential element in the 1971 programme for monetary union, thus became impossible. On May 9,1971 (19) the Council adopted a resolution in which it appreciates that circumstances may arise in which member countries may,for a limited period, be obliged to widen the margins of fluctuation for their currencies. Progressively,however,the feeling of solidarity and joint interest made it possible to adopt a common position in international monetary discussions. This facilitated the Washington agreement of December 18,1971. As part of a general realignment of currency parities,in the Group of Ten, this provided for new central exchange rates, in which the dollar was devalued and the other currencies, especially the yen and the DM, were revalued upwards. The agreement also provided for maximum fluctuation margins of 2.25 % on either side of the central rates for parities. This agreement set up a new structure of exchange rates between the currencies of the chief industrial countries of the western world;and this was to facilitate the progressive application of the internal and external monetary measures scheduled for the first stage towards the economic and monetary union. Admittedly the defective working of the international monetary system left a number of important decisions to be taken,apart from those required to deal with the more urgent necessities.

7. Resolution and directive by the Council of March 21,1972.

Monetary conditions now grew somewhat calmer, and the Council, having secured the agreement of the four candidate countries for Community membership, took a further important step towards economic and monetary union on March 21,1972. At this meeting it adopted a resolution and a directive; and in doing so, it did not limit itself to repeating the principles and objectives of the progressive plan defined a year earlier. It went further, introducing improvements and putting the process into concrete form. The determination with which the first mechanisms of monetary union were put into action justifies the belief that the movement is on the point of becoming irreversible.

a) Resolution of the Council and the representatives of the governments of of member States regarding the application of the resolution of March 22,1971 on economic and monetary union (20).

By this resolution, it was decided :

- to reinforce the coordination of economic policies,so as to secure convergence with monetary policy against a background of growth and stability. Such a coordination is necessary if it is desired that the close monetary relationships which the member countries have decided to institute, are to be proof against events. In the first instance this implies strengthening the obligatory character of the consultations between governments each time it is necessary to take an important decision of short-term policy,and especially each time any such decision involves a departure from the orientations determined in common by the member States each year. For this purpose a high-level group has been set up in the Council to coordinate short-term economic policies; and the resolution invited the Commission to submit to the Council as soon as possible a draft directive aimed at the promotion of stability, growth and full employment in the Community ;

- to accelerate the campaign for regional and structural development, more especially by the provision of appropriate financial resources. The necessary counterpart for monetary union lies in a genuine regional policy. The council accordingly stated its agreement in principle,that the european guidance and guarantee Fund be used in an after 1972 for measures of regional and structural development ; and that there be set up a regional development Fund, through which any other system of appropriate Community resources to be earmarked for regional development should be brought into operation ;

- to go ahead with fiscal harmonisation and the liberation of capital movements ;
- to proceed to individual action in the monetary field, by reducing the maximum gap between the Community currencies at any time to 2.25 %. This question will be further discussed in section 8 below, dealing with the narrowing of the fluctuation margins.

b) Directive by the Council on March 21, 1972 relating to the combat against speculative capital movements (21).

The disquieting increase in the movements of speculative capital in recent years has often disturbed the stability of various countries, and indeed the international monetary system itself. In some cases these capital movements have been of only a temporary character, resulting from short-term operations or commercial transactions, and in part from the leads and lags in the settlement of such transactions. At times, also, the de-stabilising capital movements were connected with medium-term loans and portfolio investment. The increasing interdependence between the countries, the considerable gaps between interest rate levels and the appearance of basic imbalances were contributory factors both to the frequency and to the scale of these capital movements. It has thus become more and more difficult to manage the national currencies on a purely national basis.

The Community, confronted with such problems resulting mainly, though not exclusively, from the inflow of capital from outside countries, has not been in a position to adopt appropriate instruments for regulating the flow of de-stabilising capital. Nevertheless, the Council directive of March 21, 1972 on capital movements is an extremely useful starting point for the combat against undesirable financial flows. The aim of the directive is to regulate capital movements of exceptional dimensions, especially movements from outside countries; and it seeks to neutralise their effect on the internal monetary situation in the member countries. For this purpose the countries concerned must complete their national legislation in this matter, and its application must be co-ordinated by the Commission. The directive enumerates the instruments without laying down any difference of application inside and outside the Community; but it requests each member country to take into account the interests of its Community partners. For this purpose it is recalled that the liberation of capital movements inside the Community is, in its essence, governed by the two Council directives of 1960 and 1962 (22).

8. Narrowing the fluctuation margins

Underlying the narrowing of fluctuation margins between the Community currencies are various considerations linked, in part with the problems of internal integration, and in part with recent developments in the international monetary systems. These include the limitation of the exchange risk for transactions expressed in Community currencies; the reduction of national monetary independence in parallel with the growth of the autonomy of the Community as a whole in its relationship with the rest of the world; decreased dependence on the dollar as a reserve currency and intervention currency; the application of a system for settling balances between member States, implementing the principle by which on the one hand, disequilibria in payments balances must be shown by changes in the reserves and by which the reserve assets shall be used in proportion to their composition. The latter provision keeps the payments inside the Community outside the operation of Gresham's law, which applies with special force when the various elements making up the reserves are differently appraised.

By the resolution of March 22,1971 the permitted margins of fluctuation for the european currencies in relation to the dollar, remained fixed at 0.75 % either side of par; and the margins applicable to the rates between the Community currencies themselves were to be brought down from 1.5 to 1.2 % either side of the parities between the Community currencies. Because of the 1971 currency crisis, however, this diminution of the fluctuation margins could not take place; and subsequently the Washington agreement of December 18,1971 resulted in the fluctuation margins being made wider.

It seemed desirable and possible for the fluctuation margins between the Community currencies to be kept within appreciably closer limits than those resulting from the Washington agreement. The latter were fixed at 2.25 % either side of par (or the central exchange rates) which meant a gap at any moment of 4.5 % or, over a period of 9 % between two Community currencies. With this in view the central banks of the Community countries made an agreement among themselves to make the intra-community fluctuation margins narrower. This instrument, known as the Basle agreement, came into operation on April 24,1972.

Shortly afterwards the central banks of the countries which were then candidates for membership, came into the Bâle agreement on the same terms as the central banks of the member countries. The agreement of Denmark was on May 1, the United Kingdom and Ireland on May 2 and Norway on May 23.

A very important step was thus taken towards securing the eventual economic and monetary union;for,in respect of the Community currencies,discrimination in favour of the dollar no longer exists. Since this date the intra-Community margins have been narrowed,with the effect that at any given moment the gap between the highest and lowest Community currency cannot be more than 2.25 %, whereas under the Washington agreement of December 18,1971 this maximum was 4.5 %. In parallel with this, the Benelux monetary agreement of August 21,1971 providing for even narrower fluctuation margins, a gap of 1.5 % at any given moment between the official rate for the Belgian franc and the Dutch florin, still remains in force.

If the position were to change in such a way that the strongest Community currency were to become the weakest,and vice versa, the maximum difference in rates between these two currencies could,over a period, be as much as 4.5 %. Under the Washington agreement the corresponding gap would be 9 %.

In the actual working of the system of reduced fluatuation margins, the British government decided,on June 23,1972, that it could no longer conform to it,but would allow the rate for the British pound to float temporarily,as a result of a violent outbreak of speculation against this currency. It is the intention of the United Kingdom to return,as soon as possible,within the fluctuations provided in the world system, by the International Monetary Fund and,for its intra-community relationships, within the narrower margins provided under the Bâle agreement.

The speculation against the pound also weakened the Italian lira. The Community authorities were therefore led to grant Italy a derogation to the general rules by authorising her to intervene in the foreign exchange market in dollars, in order to keep within the narrowed intra-community margin of 2.25 %.

In addition,on June 27,1972,Denmark ceased to be bound by the intra-community narrowing of the margins and returned to the system of wider (4.5 %) fluctuations provided by the Washington agreement. The Danish Crown,however, only went outside the Bâle margins for a few days; and after the referendum on accession to the Community,Denmark again came within the Community foreign exchange system. Norway, on the other hand, respected the Community system of restricted margins consistently and without interruption.

The Council decided in principle, on June 26, 1972, to conform to the Washington agreement in the new foreign exchange relationships, and also to the Bâle agreement on the Community foreign exchange system. The application of this decision will depend largely on the way in which national authorities are willing (with Community coordination) to operate in their own countries the measures for controlling the flows of de-stabilising capital, and the measures for neutralising their effect on internal liquidity.

9. The European monetary coordination Fund.

Officially the idea of a Fund came to the surface at the conference of heads of State and governments, held at the Hague on December 1 and 2, 1969. They agreed on that occasion to examine the possibility of setting up a european reserve fund, which would be the natural outcome of a joint economic and monetary policy.

The resolution of March 22, 1971, invited the Committee of Central Bank Governors, and the Monetary Committee to prepare a report on a european monetary cooperation Fund before June 30, 1972. The aim was to use the experience gained in the narrowing of fluctuation margins and in securing the convergence of economic policies to enable this fund to be set up during the first stage -- i.e. before the end of 1973. The Finance Ministers, at their meeting in Rome on September 12, decided to set up this fund. The conference of heads of State, or governments, heldin Paris on October 19-20 1972 made the formal decision to setup this fund, the formation of which requires a formal act before April 1, 1973; and the Council is required to make a formal decision on this before the end of 1972.

The management of the Fund will be in the hands of the Committee of Central Bank Governors, subject to general orientations of economic policy laid down by the Council of Ministers.

In the first phase the Fund is to function on the following basis :

- concerted action by the central banks for the purpose of narrowing the fluctuation margins between their currencies ;
- multi-lateralisation of positions resulting from intervention in Community currencies and multi-lateralisation of intra-community settlements ;

- utilisation for this purpose of a european monetary unit of account ;
- management of the short-term monetary support between the central banks ;
- the financing on the very short term of the agreement on the narrowing of fluctuation margins and the short-term monetary support will be handled together in the Fund by a new mechanism. For this purpose short-term support will be technically overhauled,but without changing its essential characteristics or the consultation procedures included therein.

The competent organs of the Community are to submit reports :
- by September 30,1973 on the overhaul of the short-term support ;
- by December 31,1973 on the conditions for a progressive pooling of reserves.

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The first beginnings of a real european monetary policy disclose one fundamental requirement -- the necessity for Community political institutions. The main decisions of monetary policy,both internal and external, are political acts, and cannot be taken except by political organs. The present Community institutions are a good basis,which could be improved on lines responding to the special requirements of monetary union. It is for this reason that a european decision centre for monetary matters should be set up as soon as possible. Community monetary policy thus raises,as a matter of urgency, the problem of political Europe and of federal institutions.

FOOTNOTE REFERENCES

(1) Harry G. Johnson, "The exchange rate question for a united Europe : internal flexibility and external rigidity versus external flexibility and internal rigidity" : Conference on Europe and the evolution of the international monetary system; Geneva, January 1972, p. 13.

(2) Memorandum of October 24,1962 on the action programme of the Commission of the European Economic Community for the second stage in the formation of the Common Market ;Brussels.

(3) Council decision of May 8,1964 relating to cooperation between the central banks of the member States of the European Economic Community (O.J. No 77 of May 21,1964 p. 1206).

(4) Council decision of May 8,1964 relating to cooperation between the competent departments in the administrations of member States in matters of budget policy (O.J. No. 77 of May 21,1964 p 1205).

(5) Decision of the Council of May 8,1964 relating to cooperation between member States in international monetary relationships. (O.J. No. 77 of May 21,1964 p. 1207).

(6) Declaration of May 8,1964 by the representatives of the governments of member States of the European Economic Community,meeting in Council concerning the organisation of advance consultation between member States in the case of any modification of the exchange parities of their currencies. (O.J. No. 78 of May 22,1964, p.1226).

(7) Memorandum of February 12,1969 by the Commission to the Council on the co-ordination of economic policies and monetary cooperation within the Community, Brussels.

(8) Decision by the Council of July 17,1969 relating to the coordination of the short-term economic policies of member States. (O.J. No. L.83 of July 28,1969).

Decision by the Council of February 16,1970 concerning appropriate methods for the consultations specified in the Council decision of July 17,1969 (text not published in O.J.).

(9) Agreement of February 9,1970 setting up a short-term monetary system between the central banks of the member States of the European Economic Community. (text not published in O.J.).

(10) Decision by the Council of March 22,1971,setting up a mechanism for medium-term financial support (O.J. No. L 73 of March 27,1971. p. 15).

(11) Communication of March 4,1970 by the Commission to the Council,concerning the preparation of a stage-by-stage plan to secure an economic and monetary union, Brussels.

(12) Report of October 8,1970 to the Council and the Commission on the setting up stage-by-stage of an economic and monetary union in the Community (the Werner report -- final text,Brussels).

(13) Report of August 1,1970 on questions raised by the ad hoc committee under the chairmanship of the Prime Minister,M. Werner and annexed to the report of October 8,1970 to the Council and the Commission on the setting up stage-by-stage of an economic and monetary union in the Community (the Werner report -- final text).Brussels.

(14) Communication and proposals of October 29,1970 by the Commission to the Council relating to the setting up stage-by-stage of an economic and monetary union in the Community, Brussels 1970.

(15) Resolution by the Council and the representatives of the governments of member States of March 22,1971,concerning the setting up stage-by-stage of an economic and monetary union in the Community (O.J. No. C 28 of March 27,1971 p. 1.

(16) Decision by the Council of March 22,1971 relating to the strengthening of the coordination of short-term economic policies of member States of the European Economic Community (O.J. No. L 73 of March 27,1971 p. 12).

(17) Decision by the Council,March 22,1971, relating to the strengthening of the cooperation between the central banks of member States of the European Economic Community (O.J. No. L. 73 of March 27,1971. p.14).

(18) Third medium-term economic policy programme (O.J. No. L.49 of March 1,1971 p.1.

(19) Resolution by the Council of May 9,1971,concerning the monetary situation (O.J. No. C 58 of June 10,1971. p.1.).

(20) Resolution by the Council and the representatives of the governments of member States of March 21,1972 relating to the application of the resolution of March 22,1971 concerning the setting up stage-by-stage of an economic and monetary union in the Community (O.J. No. C.38 of April 18,1972 p.3).

(21) Directive by the Council of March 21,1972 for the regulation of international financial flows and the neutralisation of their undesirable effects on internal liquidity (O.J. No. L 91 of April 18,1972. p.13).

(22) First directive (E.E.C.) by the Council of May 11,1960 for the bringing into force of Article 67 of the Treaty (O.J. No. 43 of July 12,1960.p 921).

Second directive (E.E.C.) by the Council of December 18,1962,completing and amending the first directive for the bringing into force of Article 67 of the Treaty (O.J. No. 9 of January 22,1963).