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REPORT OF THE STUDY GROUP " ECONOMIC AND MONETARY UNION 1980 "

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PREFACE

At the start of 1974, the European Commission asked a group of experts in different scientific fields (economists, lawyers, sociologists etc.) to draw up a study on economic and monetary union (EMU). The group of experts, called the "Study Group on Economic and Monetary Union 1980" has met under the chairmanship of Mr. MARJOLIN, former Vice-president of the Commission, in charge of economic and monetary affairs. (The names of the group members figure on a list herewith attached).

Another member of the group, Monsieur CLAPPIER, was called upon to assume other responsibilities which prevented him from continuing to participate in the work of the group. The group sincerely thanks him for the important contribution which he made to its work.

In conformity with the mandate of the Commission, and in order to continue in greater depth the examination of the development of economic and monetary union within the framework of the establishment of a European Union, the object of the study has been to undertake an analysis of the problems raised by the achievement of EMU taking into account the major changes to be expected by 1980.

In view of the originality of the problems posed by the formulation of this policy, the group was given a very high degree of freedom, both in the choice of problems to be tackled and in the methods to be considered for their solution.

The group has approved its report as a whole, although it does not reflect each member's opinions in every nuance. The coherence of the whole programme is more important than each proposal taken alone.

The report is divided into four chapters. The first draws up a balance sheet of past events and an analysis of the movement towards economic and monetary union. The second deals with the urgent problems which endanger the existence of the European Community. This chapter is followed by a short-term programme (chapter III), which given the evolution which the Community has undergone in recent years, is still largely devoted to monetary policy. In general, however, this programme can be considered as a test of the political will of the member states' governments. Finally, chapter IV examines in greater detail the first steps towards economic and monetary union.

Two annexes are added to the report : annex I contains details of the Group's proposal relating to a Community unemployment benefit scheme and which has the agreement of all the members of the Group. Annex II brings together some personal contributions.

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LIST OF THE MEMBERS OF THE STUDY GROUP "ECONOMIC AND MONETARY UNION 1980"

Chairman :

R. Marjolin	- Former Vice-President of the Commission of the European Economic Community

Members :

F. Bobba	- President of "Acqua Pia Antica Marcia", Rome
H.W.J. Bosman	- Professor of money, credit and banking at the University of Tilburg
G. Brouwers	- Chairman of the Chamber of Commerce and Industry at The Hague
L. Camu	- President of the "Banque de Bruxelles"
B. Clappier (until June 1974)	- Director-General of "Crédit National", Paris
I. Foighel	- Professor in Law at the University of Copenhagen
F. Forte	- Vice-President of ENI, Rome
H. Giersch	- Director of the "Institut für Weltwirtschaft an der Universität Kiel"
P. Lynch	- Professor in Economics at the National University of Ireland
Sir Donald MacDougall	- Chief Economic Adviser of the Confederation of British Industry, London
H. Markmann	- Director of the "Wirtschaft- und Sozialwissenschaftliches Institut des DGB"
F. Peeters	- Professor in Economics at the University of Louvain
A. Shonfield	- Director of the "Royal Institute of International Affairs", London
N. Thygesen	- Professor in Economics at the University of Copenhagen

Secretariat of the Commission :

J.C. Morel

J. Schüler

H.C.A. Tieleman

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I. THE MOVEMENT TOWARDS ECONOMIC AND MONETARY UNION - BALANCE SHEET AND PROSPECTS

1. Where have we got to ?

It became clear to the Group that in order to be able to say anything useful about the future it was essential to draw up first of all a balance sheet for the past and in particular of the results of the efforts made since the Hague Summit of 1969 towards the creation of a European Economic and Monetary Union (1).

To avoid any misunderstanding, the Group wishes to emphasize that it remains deeply committed to the idea of European unity and that this appears to it more necessary than ever if the States of Western Europe are going to be able to continue to play a rôle in world affairs and protect themselves against the dangers which threaten them from all sides. Alone, their impotence becomes every day more obvious; only unity can restore to them the influence which they have lost.

But without denying certain progress of a technical nature, notably as regards cooperation between the central banks, the Group is of the opinion that the efforts undertaken since 1969 add up to a failure. The "snake" has exploded and the "narrowing of the margins of fluctuation" no longer exists except between those currencies which are more or less closely linked with the Deutsche Mark; the Monetary Cooperation Fund only plays a minor rôle in European monetary affairs.

Europe is no nearer to E.M.U. than in 1969. In fact if there has been any movement it has been backward. The Europe of the Sixties represented a relatively harmonious economic and monetary entity which was undone in the course of recent years; national economic and monetary policies have never in 25 years been more discordant, more divergent, than they are today.

The only thing to be said is that each national policy is seeking to solve problems and to overcome difficulties which arise in each individual country, without reference to Europe as an entity. The diagnosis is at national level; efforts are made at national level. The coordination of national policies is a pious wish which is hardly ever achieved in practice.

(1) Designated hereafter by the symbol E.M.U.

The result is that when one speaks of Europe one is talking basically about a geographical entity situated between the U.S.A. and the U.S.S.R., composed of States which trade intensively among themselves but which in most other respects behav in their national affairs and in world affairs according to the trends and the particular interests of each.

This situation is felt more or less clearly by the inhabitants of this area. The idea of a united Europe, while enjoying the passive sympathy of the majority of the population in most Community countries, is not one which carries force. The goodwill with which it is generally received is usually accompanied by scepticism, because of the lack of a clear political commitment by political leaders.

The European institutions carry out the rôle assigned to them by the treaties of Paris and Rome and watch over as efficiently as possible the execution of these treaties and the administrative decisions which have been taken since their entry into force. The lack of any discernible progress for several years towards the unification of Europe means however that their authority is weakened and that they have ceased to be considered as the precursors of institutions which will watch over the destiny of a united Europe.

The Heads of State or of Government have decided to meet regularly three times a year at the Council of the Communities. It is still too soon to form any judgement on the scope of such an innovation.

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The centrifugal movement which characterizes national policies has deeply affected Community achievements.

The Common Agricultural Policy is in a state of crisis. The monetary problems which have arisen since 1969, and the frequent refusal of governments to permit the price adjustments in national currencies, which would normally have resulted therefrom, have led to the creation of a system of compensatory payments of such complexity that it is incomprehensible to the uninitiated.

The unity of agricultural prices in the Community is damaged and the single market split into several fragments which, given the attitudes of certain of them, it is hard to see being "stuck together again" in the foreseeable future.

The extent of liberalisation of capital movements within the Community is less than it was at the beginning of the Sixties. Following the more or less unilateral decisions taken by a certain number of governments, the situation in different countries varies considerably; while certain countries have maintained the degree of liberalisation previously attained, others have reimposed restrictions. No common strategy with regard to external capital has in fact come about nor does one seem capable of realisation in the near future.

The customs union for industrial and allied products is the true living element in the Community. The considerable balance of payments deficits which several member countries have to face constitute meanwhile a menace for the free circulation of goods. If the situation is not dealt with adequately, as it can only be by a coherent body of appropriate national policies, Community actions and cooperative measures throughout the western world (including Japan), there is a serious danger of seeing one country or another restore import restrictions or have recourse to other measures borrowed from the protectionist armoury.

2. The reasons for the failure

The Group considers that the causes of this failure can be traced back to three principal ones: unfavourable events, a lack of political will, and insufficient understanding in the past of the meaning of an E.M.U. and the conditions which must be fulfilled if it is to see the light of day and become operational.

The unfavourable events are the international monetary crisis which has shaken the western world since the end of the Sixties, together with the financial crisis brought about by the sharp rise in oil prices in 1973. These profound disturbances had not been foreseen when the decision to create a European E.M.U. was taken. They were not foreseeable, at least as regards the form which they took and the moment at which they occurred.

Like all crises, they could have been the occasion of progress, by provoking a crystallization of latent wills. Great things are almost always done in crises. Those of recent years could have been the occasion for a leap forward.

Why did they on the contrary cause a step back ? The fact is that at no time did the governments really try to face together the difficult circumstances. Their will did not show itself as a European will, but a series of national wills more or less unaware of those of the others, each one doing its best to find its own way out of trouble. Attempts to face up to the different crises through communal action have been timid and short-lived.

The consequences of this state of affairs have been aggravated by the fact of the decision in 1969 to create an E.M.U. in the course of the next ten years, without any precise idea of what was being undertaken. At government level, there was no analysis, even approximative, of the conditions to be fulfilled. It was just as if the governments had undertaken the enterprise in the naive belief that it was sufficient to decree the formation of an E.M.U. for this to come about at the end of a few years, without great effort nor difficult and painful economic and political transformations.

There was insufficient appreciation of the essential difference between a customs union, as defined by the Treaty of Rome, and an Economic and Monetary Union.

The Customs Union merely supposes that governments give up, except in exceptional circumstances, the use, in the pursuit of their national interests, of the instruments of commercial policy, notably customs duties and quantitative restrictions; all the other instruments of economic and monetary policy remain at the disposition of each one of them.

In an Economic and Monetary Union, national governments put at the disposal of the common institutions the use of all the instruments of monetary policy and of economic policy whose action should be exercised for the Community as a whole. These institutions moreover must have a discretionary power similar to that which national governments possess now, in order to be able to meet unexpected events.

It is practically impossible to set out in detail what these institutions would have to be or their functioning. One can say however that they would have to include a European political power an important Community budget, and an integrated system of central banks. They would be called upon to function in the appropriate fields in a comparable way to those of a federal State.

What is now being questioned is the idea which has been the basis for the past 20 years of the views of many Europeans, namely that a European political unity, particularly in the economic and monetary field, will come about in an almost imperceptible way. This was the Europe of small steps. It is clear that experience up to now shows nothing that supports the validity of this idea. One may legitimately wonder today if what may be required in order to create the conditions for an economic and monetary union is not perhaps on the contrary a radical and almost instantaneous transformation, coming about certainly after long discussions, but giving rise at a precise point in time to European political institutions.

Therefore, in view of the above analysis and given the general political and economic circumstances which exist in Europe today, it did not seem useful to the Group to draw up a plan for E.M.U. which would have a sufficient degree of credibility.

3. The objective

The Group, without underestimating the results obtained from more than twenty years of effort to integrate Europe economically, is convinced that further progress requires the manifestation of a political will. This will is today uncertain and needs to show itself and to fortify itself by action. At a time when Europe finds itself confronted with redoutable dangers, under the names of "inflation", "massive balance of payments deficits", "unemployment", the only reasonable and possible way for the member countries is to face together, and in cooperation with North America and Japan, these perils, without asking too many questions about longer term problems.

If in the presence of these grave dangers a minimum of unity and cohesion cannot be created it does not seem very useful to pursue the discussion on

E.M.U. or European Union. But if on the other hand a common will emerges in the next year or two, concerning concrete, precise and urgent problems, Europe will find itself at the end of this short period in a situation such that the grand designs which have been discussed by the Summits of recent years might once again seem conceivable. New plans could then be drawn up with some chance of realisation.

It is for these reasons that the Group devoted a considerable part of the time available to it to the analysis of the dangers which threaten not only Europe but also each of the member countries taken on its own, and to drawing up a list of actions which should be undertaken to overcome the dangers and prevent the disappearance of what still remains of Community achievement.

Moreover it considers that the governments should without delay, during the course of the phase of one or two years mentioned above, take a certain number of decisions whose effect is in the longer term and which would increase the degree of interpenetration of the Community economies, reinforce their unity in face of the dangers which surround them and bring nearer the time when the creation of an E.M.U. might be seriously envisaged. These decisions concern primarily the abolition of obstacles to the movement of goods, services and capital; the development of financial solidarity; and the establishment of a Community budget on such a scale that the important transfers which the maintenance of E.M.U. will require can take place and be financed out of Community taxation.

II. URGENT PROBLEMS

Three sources of difficulties menace the Community: inflation, unemployment and balance of payments deficits. These threats reveal themselves in a crisis atmosphere in wich everyone wonders about the structural changes required, the future level of growth and even its nature.

1. Inflation

The rise in prices has not ceased increasing during the last few years. Consumer price inflation was about 3 % a year from 1958 to 1968, on a weighted Community average; for the years 1969 to 1972 it reached 5.6 %; but was 8.2 % in 1973 and more than 13 % in 1974. This acceleration is partly to be explained by the expansionary measures taken in the industrialised countries, which were similarly excessive following the minor recession of 1970-1971. On the other hand governments and central banks let expansion take a grip in 1972 and 1973 without taking in time the restrictive measures required in the monetary, as well as in the fiscal and budgetary fields. In particular an increase in the volume of money in Member states of the order of 9 - 29 % a year between the end of 1970 and the end of 1974 was evidently incompatible with the objective of price stability.

The price of industrial raw materials during a period of high demand, even of speculation, increased very rapidly. The Community was partly spared the rise in the price of food thanks to the Common Agricultural Policy. From the summer of 1974 the effects of price ~~increases~~ in raw materials on the general price level have substantially weakened.

The rise in the price of oil, intruding at the end of 1973, was much more brutal and its consequences much deeper; as a result of its mechanical effect [1)] alone, the direct increased price of energy accounts for a quarter or even a third of the increases observed in consumer price levels in 1974.

(1) in termes of input - output analysis.

At the start of 1975, there was every reason to believe that the majority of inflationary factors, as well as the pressures on demand and egogenous factors such as the increased cost of raw materials and energy, had disappeared but one should not overlook the need for sufficient time to elapse for these effects to have completely worked through. The pressure of wage costs however remained strong although the situation varies greatly from one country to another. In these circumstances one could expect a slowing of inflation in most of the countries without being able to hope that it would be very significant. The rate of inflation established is too strong for behaviour to change from one day to the next.

Continuing to finght inflation remains, however, essential in the Community. This fight is sometimes made difficult by the complexity of those situation in the Member states and their very different positions inclusding in industrial relations. In effect, some countries such as Germany which had applied the brakes sufficiently early during the expansionary phase possess an advantage with respect to the price stability objective. Nevertheless, it is presently a matter of simultaneously fighting inflationary pressures, through at different degrees, and against a too marked slowing down in the economic activity accompanied by growing unemployment.

2. Unemployment

At the end of 1974, the Community had about three and a half million unemployed; when related to the active population this represents a rate of 3.3 %, a figure never before attained since the creation of the Community. In some countries the proportion of unemployed in the working population has at that time exceeded 5 % (in Italy) and even reached 8 % (in Ireland) while other countries experience a problem on a smaller scale i.e. 3 to 4 % (in France, Germany and the United Kingdom).(1)

In normal times without doubt such a solution would call for restimulating the economies by aggregate demand measures. In the actual situation this evaluation must however be tempered. Stimulation must have more emphasize on investments and should be more pronounced in the countries with a balance of payments surplus. The deficit countries should take the necessary measures to adapt their production structure to the new demands of the oil producing countries.

(1) : According to the forecasts made by the services of the Commission for 1975 (annual average), there will be a slow decrease in the total unemployment rate in relation to the position in December 1974 (Ireland 7,5%, Italy 3,9 % and the other countries around 3%).

Otherwise, it should be emphasized that at the present stage, unemployment in part can be explained by structural phenomena. Changes in the production equipment have become inevitable principally in order to respond to the new structure of demand induced by the different hierarchy of prices (particularly by the increase in petroleum prices) and by changes in the world distribution of wealth. Taking into account the frictions, the probable result, during the next few years will be a slower growth and a higher and longer lasting structural unemployment. An active labour market policy will therefore become that much more significant, including occupational retraining assistance for workers together, eventually, with appropriate changes in the wage structure. Such actions would also tend to increase the flexibility of the economies with respect to restructuring requirements.

3. Balance of Payments Deficits

The return to satisfactory equilibrium in the current balance of payments and that in an orderly manner, is rightly the vital question for the preservation of the Community.

The massive transfer of liquidity to the oil producing countries has shaken the fragile structure of the international monetary system and changed the geographic distribution of financial resources.

The deterioration of the terms of trade to the benefit of the oil producing countries implies that the Community should progressively release the internal ressources required to compensate for this deterioration by additional exports.

In fact, the oil producing countries are not in a position to immediately transform all their additional gains into more imports. For several years they will have a non-absorbed surplus, part of which will find its equivalent in the present Community deficits.

In 1974, the external deficit of good and services of the Community reached about $ 13,000 million to $ 14,000 million. If one can hope for a progressive diminution it will not be before some years have passed that an equilibrium position will be found. From now until 1978 the accumulated debt of the Community could

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clearly exceed $ 50,000 million and even reach $ 100,000 million [1]. This phenomenon is more worrying given the very different situations between one member country and another, from a considerable surplus for(about 14 million dollars) Germany to a very noticeable deficit for Italy (about 11 billion), the U.K. (about 13 billion) and France (about 5 billion). These countries alone have thus registered a deficit in the order of $ 29,000 million in 1974.[2]

In these circumstances, there is a danger that countries experiencing the greatest difficulty might be tempted to adopt restrictive commercial measures or be forced to competitive depreciations creating a chaotic situation in the exchange markets and causing a crisis of the customs union.

One of the problems which Europe must try to avoid is the creation of excessing tensions between countries with surpluses and those with deficits in their current balance of payments. In some cases setting up coherent and order by financing schemes would seem inevitable. These problems cannot be solved within the Community alone, but in the wider context including the strategy adopted by the three groups of countries concerned: the principal petroleum producers, industrialised countries and, developping countries.

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(1) Source: Report to the Council and the Commission on the Community's economic situation and medium-term outlook, document by the European Communities (Economic Policy Committee) no II/562/74 of 18 December 1974, p. 36 and following pages, especially pp. 50-53. The figures calculated in that source refer to the year 1973.

(2) estimates of the services of the Commission.