COMMISSION
OF THE
EUROPEAN COMMUNITIES

The President

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THE INTEGRATION OF THE COMMUNITY IN THE FACE OF ENLARGEMENT

This evening I should like to talk to you about a principal issue that now faces the Community : how and why we should resume our pursuit of monetary union and economic integration at the same time as we face a second enlargement of the Community.

The applications for membership of the Community from Greece, Portugal and Spain have rightly been welcomed. Despite the fact that the last enlargement took place only four years ago, and in some respects was only formally completed this year with the end of the transitional periods, the Community should embrace this prospect of enlargement to the South. The reasons are simple and primarily political. First, the Community was founded in the duty to cherish and nurture parliamentary democracy and individual liberty. Whatever our other difficulties, these remain our entrenched values. The recent emergence

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democratic regimes in the three applicant nations calls for a direct and full-hearted response from the Community. To fail to give such a response would run the risk of undermining the very democracy for which we stand. The political attraction of application underwrites our fundamental political purpose.

Second, whatever our economic difficulties or lack of internal integration, we must be open to democratic European states who are anxious and qualified to join. It is much better that there are those who want to apply rather than there are those who wish to leave.

But, despite our overall political aims, the central thrust of the Community remains economic, and there is no doubt that the combined weight of the three applicants would add to what I would describe as the 'poor-end' loading of the Community. Naturally there are important differences between the three countries concerned. The Greek and Spanish economies, and standards of living, are generally little different from those of Ireland or Southern Italy. The economic situation of Portugal is qualitatively and quantatively of a different order. But the overall net effect will add to the Community's economic problems.

The pessimistic reaction in these circumstances would be to accept the political inevitability of enlargement and an accompanying weakening and dilution

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of existing Community integration. I believe this approach to be profoundly mistaken. It is politically inconsistent with the Community's aims, and it is, in my view, based on a false analysis of the options open to us. I would also add that it is the last thing the applicants themselves want. Why should they go to the trouble and take the political risk of resigning from one free trade area, E.F.T.A., only to find that at the end of the day they have, by doing so, joined another which has slipped back to a simple common market ?

But it is not only a problem for the applicant countries themselves, or just a question of enlargement. The existing Community, in any event, has to face up to its more pressing economic problems, and that is why the Commission has decided to give a new, more urgent and contemporary impulse to the old idea of economic and monetary union, particularly its monetary aspect.

First, I should like to outline what, in my view, are the seven basic reasons for pursuing monetary union today. I will only summarise these arguments, since I have already set them out in some detail in my Jean Monnet Lecture in Florence in October. But I shall follow this summary presentation by a review of how these arguments appear to be standing up to public scrutiny and debate. I should like to conclude with some thoughts on this week's European Council in Brussels.

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The seven reasons for renewing and relaunching the Community's programme for attainment of economic and monetary union are a combination, on the one hand, of what I believe are new arguments, and, on the other, traditional arguments, the combination, contrary to much opinion, being stronger in the circumstances of the late 1970s than it was at the beginning of the decade.

The first, and traditional argument concerns the rationalisation of trade and commerce, which comes with a customs union. The latter is a great achievement, but it is, in my view, always under some threat, and one which could both be safeguarded and further advanced if the customs union became also a monetary union. The inter-penetration of Member States' is a reality; more than half of each member country's exports goes to its /partners in the Community. No Member State can get away from these facts, or hope that markets in third countries, least of all in new competitive circumstances, would provide a substitute for the integrated economic area provided by the Community.

The second, third and fourth arguments concern the traditional objectives of macroeconomic policy - employment, stability and a sound external payments position. These objectives are traditional and common to the policies of all Member States. But there are two new aspects. First there is the extent to which Member States have suffered a deteriorating outcome in trying to combine the three objectives. Second, there is the extent to which monetary union accompanied by policies for economic integration offers itself as

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one of the major keys to securing, in the long run, a basic improvement in the economic environment. To these central arguments I will return later.

Monetary union would also directly affect our influence on world monetary affairs. Today we have not got a proper world monetary system. We had one for 25 years after Bretton Woods, and on the whole it worked very well. But it was based on a complete dollar hegemony. It began to crack in 1968. It fissured in 1971. Since then it has just staggered on. And today the dollar looks less satisfactory than ever as the only real international medium of exchange that we have. Its continuous weakness can be a great de-stabiliser. The Community is the world's leading trading power and its second economic power, and the formation of a monetary union would permit the Community to play a major and perhaps decisive role in the restoration of order to the international monetary system. It would also mean that the Community's economy as a whole would would be managed under less severe and erratic external financial constraints than at present.

Economic and monetary union would certainly not remove the need for disciplined efforts throughout the Member States to tackle inflation; on the contrary, it would increase them. But these efforts would be recompensed by greater rewards. Monetary union would provide an opportunity for establishing a new standard of European price stability. Of course, such a new standard would still require of the Community

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authorities and all Member States a determination to make out of it a continuing era of monetary stability. But some part of the present problem of inflation would in any case be eliminated, notably the transmission of inflationary impulses due to intra-European exchange rate movements. In addition, the historic act of monetary union and thereby monetary reform could introduce a decisive break in the inflationary psychology of recent years.

The fourth argument concerns employment. Here I believe that economic and monetary union could be a decisive contribution to the major new stimulus now required to reverse the deep recessionary tendencies which are widely established throughout Europe and are manifestly of much more than cyclical proportions. A common monetary policy, together with a significant degree of common budgetary action, would favour a more reliable, sustainable and more evenly spread growth of demand. It would be less inflationary than recent historical spurts of growth, and hence give a further strenthening to business confidence and investment.

The fifth argument concerns the regional distribution of employment and economic welfare in the Community. Experience has shown that the integration process contains no invisible hand that guarantees an even spread of the increased economic prosperity that the customs union has produced, or a monetary union would further generate. The economic part of a revised approach must therefore be strongly

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directed towards correcting the Community's structural problems. And this must both deal with sectoral problems, for example in the energy field, and a number of major branches of industry, and with the problem of regional imbalance. This will require a steady but solid development in the Community's power to direct budgetary and capital market resources into the weaker regions and Member States.

My sixth point is constitutional as well as economic. It concerns how the centralisation of some macroeconomic powers inherent in the formation of an economic and monetary union can be reconciled with the profound pressures in all our Member States favouring a maintained or increased decentralisation of government. Monetary union does not offer much possibility for compromise in the sharing of responsibilities between the levels of government. On the other hand, the budgetary and economic aspects of union offer very much greater scope for the sharing of responsibilities between the Community and Member States. The Community must look for an original model for the organisation of economic and monetary union in which the Community would take on the minimum degree of centralisation adequate for the task. We should be neither dismayed nor constrained by existing federal models.

The seventh argument is essentially political. Economic and monetary union would carry the Community over the threshold of political union. But there

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are also two shorter-run political factors of great relevance. The first is the question of enlargement. On this I should like to add one point to what I have said already. It is not the case that an equality of performance is a pre-requisite for an effective monetary union. Common policy, common disciplines, yes, obviously yes. But not the same standards of living, levels of output in Hamburg and Palermo, or in the future Copenhagen and Lisbon. Monetary unions have worked to the benefits of both richer and poorer areas with at least equal discrepancies in the past. They do indeed work within our Member States today where the natural discrepancies are very great, although greatly evened up by fiscal transfers. This distinction is vital. If equality of performance were necessary, it would be meaningless to talk about economic and monetary union for our lifetime or even our children's lifetime. I therefore do not regard enlargement as a bar to economic and monetary union, but rather as making it essential.

The second political factor is the campaign which will take place for the first direct elections to the European Parliament. This is an eminently suitable occasion for the people of Europe to engage in a major debate on the profound issues which economic and monetary union both senses and, in my view, helps to resolve.

I present these arguments in this foreshortened way as a backdrop against which I should like to discuss some current reactions to them. I shall do this

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under three headings :

- first, institutional questions;
- second, questions of economic argument;
- third, questionsof political attitude.

On institutional questions, I have found a clear echo of opinion which accepts the proposition that we face a problem of the level at which economic and monetary policy is organised in relation to international investment, capital and the business cycle; put another way, we face a problem in the failure of public policy to be adequately organised in relation to the private economy. This view is not as pessimistic as it may sound. It implies our capacity for a better economic performance in Western Europe has not been fatally reduced, and that economic theory and policy are not quite so badly at sea as is sometimes suggested. The crucial problem here is that small and medium sized European states using their levers of monetary and fiscal policy independently cannot adequately face up to the international dimension of the economic phenomena they are trying to control.

German commentators and opinion formers are uniquely well placed to participate in this kind of institutional analysis. You alone among Community countries have a solid grounding in the mechanism of a federal system. In your history you have experienced looser confederal forms of organisation - notably in the middle of the last century. Now you have a strong federal structure, one that is tighter in its degree of central harmonisation (for example on taxation matters)

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than in Switzerland or the federations of the new world. Admittedly some other of our Member States are now introducing constitutional reforms - and I am thinking here of Belgium, Italy and the United Kingdom. But the essential point here is that you in Germany can contemplate maturely and open-mindedly the wide spectrum of arrangements for multi-tiered government that may be compatible with the functioning of a modern, industrialised economy. You will, I hope, examine carefully the rather special basis for the development of the Community's functions that I am presenting, and indeed put to the European Council this week. It is one in which the centralisation of monetary policy would be necessary but in which the distribution of fiscal and other financial powers would be a very different matter. I suggest in particular that we might contemplate a Community intervening only to a very minor degree in the supply of public goods and services. Community public expenditure as a share in GNP might remain no more than perhaps a fifth of that seen in the average modern federal state. (This would be inclusive of central social security transactions - I know that in Germany you conventionally distinguish more strongly between budgetary and social security finances than in many other countries.)

Two other features of the Federal Republic today are also of relevance in this context. The first is a capacity for bold reform in the monetary field. In particular I recall Ludwig Erhard's monetary reform of 1948, when he went ahead and succeeded only after a

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chorus of experts and officials had told him that it could not be done! The second feature is the institutional position of the central bank. Here I think we should note the simple but impressive fact that the three most successful and stable economies in the western world - the Federal Republic, Switzerland and the United States - have clearly the three most independent central banks - and also have federal or confederal forms of government.

These are good reasons why Germany should be a major source of intellectual and I hope political initiative in the construction of Europe, and why others in the Community should listen to your arguments and experience very carefully. I hope our initiative in relaunching the debate on monetary union will stimulate an imaginative and professional contribution. Let me be more precise, for there are many questions to be answered. For example, how far could a relatively independent European monotary authority delegate operational responsibilities to the national banks? Is it effectively possible to devise a more decentralised monetary and banking system than that found in the United States, which is already more decentralised than in the Federal Republic ? How should one envisage the evolution of the Community's monetary and political development with the evolution of its budgetary powers? These can be of three types :

- transfers attached to macroeconomic conditions, clearly appropriate in the early stages of integration;

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- transfers linked to the joint financing of specific tasks as in your 'Gemeinschaftsaufgaben' or our Regional or Social Funds;
- transfers devoted to budget equalisation purposes as in your 'Finanzausgleich'.

These latter transfers understandably find no equivalent in the Community of today, but clearly have their place in a more mature political structure.

These are questions that I know some of you thought deeply about in the early 1970s. If I encourage you now to do so again, it is because I believe there are powerful, new economic arguments pushing us in that direction. The consistent German thesis - that monetary union and stability, resource transfer mechanisms, and political integration - have to be seen as an interdependent and indeed indissoluble whole, is, in my view, right. An advance on any one front alone cannot succeed. The challenge is to apply our imaginations in a constructive and practical way so as to make measured progress on all three fronts together.

I turn from institutional and budgetary questions to those of economic argument. I have argued that a European monetary union, buttressed with the right complementary policies, would greatly improve economic welfare in Europe through inducing more intensive trade and commerce, creating a more favourable international monetary position, through

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reducing inflation and increasing employment. These are bold assertions, but the difficulties being experienced with present policies in achieving these objectives, notably in their international dimension, can hardly be doubted. Since, at the same time, the genuineness of efforts in all our countries to do better by conventional means cannot also be doubted, this makes the need to look to more radical treatment even more compelling.

What therefore seems the current reaction to the economic case ? On the first two propositions, concerning trade and the international monetary system, I have heard no real disagreement : the benefits to be obtained by the Community in forming a full monetary union are vast - and increasing when we give weight to the vulnerability of international trade and the relative weakness of the dollar. Put the other way round, the cost of disunion is becoming increasingly obvious and heavy.

There has been more hesitation in accepting my argument that monetary union would offer a far more favourable combination of employment and price stability than seems achievable in present circumstances by conventional policies. I would like therefore to elaborate on this. There are two arguments here, one negative and one positive.

The negative argument consists of recognising that it is no longer true that each of our Member States has to accept that there is an immutable relationship between employment and inflation. In terms of economic theory, they need no longer believe they are fated by the so-called "Phillips Curve" relationship. Inflation prone countries have learned convincingly that you cannot buy higher employment with higher inflation. But the converse of this now common-place observation is interesting : higher employment may well be achievable without causing higher inflation. Of course some deeply felt historical differences of view between our peoples, notably as regards inflation, have not evaporated - and a German audience will confirm this. But this is not an objection nor an obstacle to setting out to improve, according to your starting position, either or both the inflation and unemployment situation. The Community inflation and employment record should in no way be, expected to be fixed to the weighted average performance of Member States over some recent reference period.

If this is so, what then of the positive opportunities to do better ? Here I invite you to reflect for a moment on the situation in Europe today; to reflect on the reasons why no Member State appears able to move more quickly ahead towards our shared objectives for employment and stability.

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I start with the Federal Republic. Germany resists - at least in its extreme form - the so-called 'locomotive theory' of cyclical leadership by the more powerful economies whose balance of payments position is strong. It is current among some Anglo-Saxons, but I understand your argument. Virtually every German boom since the war has been led in no small measure by strong export demand, leading to a strong consequential tide of private investment. German industry is so export-oriented that it is looking for firmly based expansion of overall demand in its European markets. You can take the horse to the water but you cannot make it drink. To extend more expansionary fiscal or monetary credits risks causing the trough to flow over with inflation. Therefore the attractiveness of pulling further on the levers of domestic demand management policy seems limited. You cannot, in the conventional international setting, have an important effect on foreign demand without risk of domestic instability - but the situation within the setting of a European union could be substantially different.

Let us look then at the other medium sized European economies. Those which, from the point of view of monetary policy and prices are vulnerable, are compelled to adopt a cautious demand management policy. If they do not, there is the risk that a bolder policy will result in a sharp drop in the exchange rate with extremely harmful consequences for domestic inflation and hence business confidence.

The smaller countries of the Community, for their part, share the situations of one or other group of the larger countrie except that the external constraints on the effects of any economic policy measures that they take will be even greater.

The result is a sort of economic stalemate. The countries which are under no external financial constraint are nonetheless reliant on the weaker countries for the efectiveness of their policies. But the more vulnerable countries are themselves unable to act on the basis of the collective economic and financial strength of the Community as a whole.

This is a recipe not only for immobility and stagnation, but also for producing, in biblical terms, not "the wages of sin" but the 'wages of frustrated economic expectations'. The contemporary economic bible surely demonstrates that the wages of frustrated economic expectations are inflation and social discontent, circumstances in which it is impossible to recreate business confidence and a strong business upswing. Community interdependence in trade, finance, exchange rate and price behaviour is intense, but our system of inter-governmental cooperation and embryonic Community instruments demonstrably do not match that intensity: what other conclusion can be drawn from the continuing lament in official statements from each of our European countries that they cannot 'on their own' assure the turn-round in international conditions that are required to change the domestic economic outlook?

Some would here argue that improved coordination should be the full answer. The Community should, of course, play a full part in improving its effectiveness, but let us keep a sense of perspective as to its potential - after all, our efforts to coordinate have been genuine enough for a good number of years.

In a properly designated European monetary union the outlook could, I believe, be radically different. The result would be single, homogenous monetary policy, setting, and indeed maintaining, a common high standard of price stability. It would have to be based on a well-prepared currency reform. This reform would have produced a decisive break on inflationary expectations, and on the inflationary impulses from exchange rate changes within Europe. The international monetary constraint on economic policy would also have been removed between Member States, and greatly diminished as regards our monetary relations with the rest of the world. This would be a new economic environment, of stronger internal monetary disciplines, but more relaxed external financial constraints. To work it would have to be coupled to important Community budgetary and financial powers, better geographical balance in cyclical conditions, in the structural reconversion of declining industries, and in the smoother development of demand. These are the conditions in which we would have a right to expect business and labour again to look forward to a sustainable and broadly based economic expansion. I do not believe this view of the future is either unrealistically academic nor foolishly utopian.

I am describing the technically achievable reforms in the organisaion of monetary and, to a lesser but still important degree, fiscal policy that would allow Europe's undoubted potential for a more stable and employment-creating growth to be released. I do not accept that Europe's potential in these respects has been irrevocably damaged in recent years. What I believe is that in a Europe of 6½ million unemployed, and in a Europe in which stability and employment are not so much competing but complementary objectives, we should not be hide-bound and confined by the assumptions and conventions of the past, but ready to contemplate institutional reforms.

There remain those who say that employment problems are a matter of political urgency, but such proposals are addressed to another, longer time horizon. But there are three replies to such a criticism.

- First, our employment problem is, I am afraid, now a medium term, rather than an ordinary cyclical matter. Moreover, beyond the 6½ million unemployed of today there are 9 million more young people who between now and 1985 are going to be added to the Community labour force looking for new extra jobs; and the Federal Republic is, because of its population profile, at the top of this list. Thus we have to think in terms of a new medium-term stimulus for the European economy - a stimulus which will have to be of some historic dimension to meet the extent of our present and prospective employment problem.

- Second, while monetary union is clearly not for the very short-run, I would not wish to push it over the horizon. We should be prepared to take preparatory decisions and proceed as fast as those who want to succeed together and be convinced of the arguments. To

If a new design for the Community's monetary union and economic integration gains support in the debate that we are now initiating - in all the Community's institutions and in the public at large - then we should look very seriously again at the length of the time-horizon.

- Third, and for the short run, I would by no means underestimate the favourable effect on business confidence in Europe of the Community deciding to embark again seriously on a renewed and intensified approach to economic and monetary union. Our European Council earlier this week was in this respect encouraging - although not in itself decisive. These are early days still, and much more remains for next year, but we have achieved a 'fair wind' for our new approach. But this European Council also broke through some log-jams. It agreed in principle to a new Community loan mechanism; it resolved certain budgetary problems thus opening the way for the new unit of account and own resources in the 1978 budget; strengthened our short and medium-term balance of payments mechanisms, supported the build-up of Community industrial policies,and looked forward to new proposals on youth employment. This is a considerable list of practical achievements and they are all useful steps towards building up the sinews of an integrated economy. If we can succeed in presenting in the next year a convincing and well-understood plan of action - relating today's steps with tomorrow's design - that in itself should substantially improve the general morale of the Community, of workers, managers and investors, of industry and of governments.

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I hope that German opinion will join in this new revival of an old debate with vigour. In terms of economic policy, you may be reluctant to embrace the so-called 'locomotive theory' for international economic coordination; some of you may now even be hesitant about a strong new Community initiative. I understand both these attitudes. But in the final analysis, I believe that German interests cannot be well served by resisting both proposals at the same time. My inclination would certainly be to support international economic cooperation but to give primary support to the construction of a hard-core integrated Community economy along the lines I have tried to describe. I am encouraged that the way is now open in the Community institutions to take up the central questions afresh. It is thanks in no small measure to the helpful position taken up by this week's European Council. I hope for a vital contribution from the Federal Republic as a whole. Your strength as a greatly respected industrialised and democratic society inevitably gives you both opportunity and responsibility in the construction of Europe.

I should like to conclude with a general political reflection. It has recently been said that Europe cannot be united by money alone. Indeed this was the published view of Herr Apel on 2nd December. I agree with him. I also agree with him that there is no alternative to European integration. But I also believe that there can be no such full integration without a decisive monetary step. That is why the platform from which we launch this debate is a broadly based one - it is monetary, of course; it is also clearly economic; but it is also political and institutional; we must fashion our policies, short term and medium term, with the firm purpose of further Community integration, made more than ever necessary by the prospect of enlargement.

This requires for both strong and weak a combination of benefits and sacrifices, certainly not all from one side, certainly not all to the other. But it requires above all a realisation that the Community creates and does not merely redistribute. It has not been and must not be thought of as just taking from one and giving to another. It must benefit us all, strong as well as weak, otherwise it will never move decisively forward. And it must always remember its political purpose, inspiration and goals, even though its means must be largely economic.