Address by Roy Jenkins, President of the Commission of the European Communities to the Basle Society of Statistics and Political Economy on Monday 13 November 1978

Next year it will be the 10th anniversary of the decision taken by the Heads of State and Government of the Community to work towards an economic and monetary union. The progress which has been made since then has been disappointing, but the objective remains intact. We are now making our second major effort to move towards it through the establishment of a zone of monetary stability in Europe to be achieved through the creation of a European Monetary System. If we succeed we shall give our Community the most creative impulse since the first achievements after the signature of the Treaty of Rome; if we fail we shall risk not just a minor setback but the frustration of one of our fundamental purposes with all the political and economic consequences that would entail.

Before looking at the choices which now face the member states of the Community, I want to say a word or two about how and why we arrived where we are. Just over a year ago, I tried to set out in a speech at Florence the reasons for re-examining the case for economic and monetary union. I wanted thus to take the issue out of the realm of academic debate and bring it back into that of live politics.

Florence speech

I do not need to rehearse the main arguments I then advanced but I will briefly mention them. I drew attention to the need for a more efficient and rationalized development of industry and commerce in Europe. I spoke of the so far unexercised ability of the Europeans to create a currency of their own, based on a spread of wealth and power comparable with those of the United States: in doing so I said that although I thought floating exchange rates were here to stay, they should be between continents rather than between the countries of Western Europe, all of which are intermingled in a thickly populated half continent, and nine of which are united in a common market and pledged to political and economic integration. I said that control of a single European currency by a single European monetary authority could achieve a measure of anti-inflationary discipline beyond the reach of most individual member
states. I argued that policies which would favour sta-
tility and expansion, strengthen demand on a broad
graphical basis, and avoid exchange rate crises,
would give a much needed new impulse on an historic
scale to the European economy with the effect of reduc-
ing unemployment and creating new wealth through-
out the system. I referred to the need for redistribution
and transfer of resources within the system so that pub-
lic finance could be channelled to the poorer areas and
the imbalances which continue to disfigure Community
Europe could be counteracted. I called for decentrali-
ization in some fields to balance the centralization which
would be necessary in a limited number of others. Fini-
ally I spoke of economic and monetary union as a
means towards political integration and the ultimate
European union to which the member states of the
Community are committed.

Speed of developments
Since then things have moved further and faster
than I — or I think anyone else — thought possible. Per-
haps I should single out two main reasons for this
change of climate. The first is that people became bet-
ter aware that the differential movement of European
currencies against each other was making nonsense of
the notion of a common market, and still more that of
a Community. Those countries in surplus, mostly
strongly export-oriented, found that decline in demand
from countries in deficit held back their ability to stimu-
late their economies; while those in deficit were frustrat-
ted in their efforts to achieve higher growth by a
succession of exchange rate crises. Hence, in part, the
relatively poor productivity of Europe, the relatively
poor rate of growth and the relatively high rate of
unemployment, all of which stood in marked contrast
with what had been achieved in Europe in earlier de-
cades of relative monetary stability. The United States
and Japan, subject to intercontinental but not to inter-
nal monetary upheavals, performed better.

Weakness of dollar
The second major factor was the continuing weak-
ness of the US dollar and the increasing precariousness
of the international monetary system of which the dol-
lar remains in practice, although not in theory (as under
the Bretton Woods arrangement), the essential pivot.
To keep some sort of system going and discharge their
responsibilities in the common interest, the Europeans
took in more dollars than they could conceivably want
or need. This in turn had drastic effects on the ability of
European governments to control their own money
supply. In circumstances in which the world system
was manifestly failing, the Europeans not unnaturally
felt that they should try to achieve some stability
among themselves both for its own sake and in order to
make a contribution to a new and better balanced inter-
national system in the future. I shall have a word or two
more to say about this point later on.

For nine months now we have been talking about
the creation of a European Monetary System, and I
hope — as is appropriate — that the birth is about to
take place. Since the Copenhagen meeting of the
European Council in April much work has been done,
thanks in large measure to the impulse given by Chan-
cellor Schmidt and President Giscard d’Estaing. The
measure of agreement reached at the European Council
at Bremen astonished the world and laid the basis for
the detailed and technical work which is under way. As
you know, we then envisaged that the European Coun-
cil at Brussels next month should approve the creation
of a European Monetary System to come into being on
1 January next year. The creation of such a system
would not of course be the same as a European eco-
nomic and monetary union, but it would be a major
stride towards it.

No back-sliding from Bremen
Success, while far from certain, is still well within
our grasp. I want in the rest of my talk to consider some
of the problems which have arisen and what might be
done about them. First let me say as clearly and firmly
as I can that there must be no back-sliding from what
was envisaged at Bremen. There is a particular respon-
sibility on those who then took the lead. The detailed
and technical work to which I have just referred and
which is of course essential if we are to achieve anyth-
ing worthwhile, must not nevertheless be allowed to
obscure or diminish the fundamental perspective of
Bremen. Let me recall what these were. First the
European Council agreed that the creation of a zone of
monetary stability in Europe was a highly desirable ob-
jective: the European Monetary System whose purpose
was to bring it about must be durable and effective.
Secondly the European Council agreed to work on the
basis of a specific scheme for the creation of a
European Monetary System although it naturally left
this scheme open to amendment if necessary. Thirdly
the European Council agreed that there should be con-
current studies of the action needed to be taken to
strengthen the economies of the less prosperous mem-
ber countries in the context of a European Monetary
System, and stated that such measures would be ess-
ential if the zone of monetary stability was to succeed.

The essentials of the scheme on which all agreed to
work can be stated as the creation of an ECU (or
European Currency Unit) at the centre of the system
and as a means of settlement between Community
monetary authorities; the depositing of reserves for use
among Community central banks (illustrative but im-
 pact-making figures of 20 per cent of the gold and dol-
lar reserves of Member States and 20 per cent of their
national currencies were cited); the co-ordination of
exchange rate policies with regard to third countries;
and the eventual creation of a European Monetary
Fund. I recall these points because they are in some
danger of being buried beneath the leaves of an au-
tumn of detailed discussion. But the decisions at Bre-
men and the essentials of the scheme on which all agreed to work are the indispensable basis of what we intend to set in place next year.

Parity-grid versus basket of currencies

Some of the arguments which have taken place in and out of the Community institutions and between governments necessarily have a highly technical character. At the same time most cover points of underlying importance. First there has been the discussion about the choice of numeraire for the new system. Should exchange rates be defined in terms of a parity grid, as in the present snake? Or should they be defined in terms of a basket of currencies, the basket in this case being the European Currency Unit whose composition would be the same as that of the present European unit of account? These are strong technical arguments for using the grid as the method of intervention, but there has also been an underlying division between those countries at present in the snake who fear that the introduction of a basket system would impose unwanted responsibilities on them and promote inflation; and those at present outside who fear that the introduction of the parity grid would tilt the system in favour of creditor countries and impose an unwanted degree of deflation. I will not enter into the details of the argument, which I have no doubt are well known to you, but will simply draw attention to the so-called Belgian compromise which would define intervention obligations in terms of a parity grid, but use the basket as an indicator of divergence, that is to say would show whether creditor or debtor countries were getting out of line, and thus impose a certain symmetry of obligation. This argument is not resolved; but I have no doubt that it can and should be in the near future.

Importance of adjustment

Second there has been discussion about the width of margins to each side of the numeraire, and the possibility of adjustment. Here again there is some conflict of interest between those who are happy to retain the present margins of the snake and those (one at any rate) who would prefer wider margins. This is an argument over percentages into which I shall not enter. The question of adjustment is more important. Any participant in the system must be able to change its central rate if its costs and prices move out of line with those of its competitors or if it has undergone a structural change in its balance of payments. This is already true of the existing snake arrangements. It would obviously be contrary to the spirit of the whole enterprise if certain countries, in particular those with relatively high rates of inflation, availed themselves too often and too easily of the possibility of change and made no sustained effort to bring their inflation rates down to the level of their partners. Nevertheless some flexibility must be built into the system, and some of the fears which have been expressed about its absence seem to be ill-founded.

Reserves and drawing-rights

Next there has been substantial discussion about the extent of the reserves on which members of the system can draw, and the conditions on which they could do so. The Commission's position is clear: we support the arrangements set out in the scheme discussed at Bremen. There are a number of legal and even — in some countries — constitutional obstacles to be overcome but in order to ensure that when the new system comes into operation there will be sufficient financing to back it up we must at least agree substantially to strengthen the existing network of credit facilities. Here I think two improvements could be introduced: first the duration of the very short-term financing — the unlimited bilateral support that central banks can draw upon to finance their intervention operations — could be extended; and secondly the present network of short and medium-term credits should be increased in amount, from around 10 million European Units of Account at the moment to around 25 million. Obviously the larger the credit facilities, the less they are likely to be called upon. The more you have the less you need. There is no economy more self-defeating and short-sighted than to fail to provide adequate measures.

Convergent economic policies

The issues underlying the so-called technical points are obviously of great importance. But they must be seen in the wider context of our continuing and now more determined efforts to bring about greater convergence in the economic policies of the member states of the Community. Any arrangement for the future which was exclusively monetary would be bound to fail. The economies of the Community are now moving along more parallel paths than was the case a few years ago. Their trade with each other is immense. But the differences between them are still substantial. Inflation rates vary considerably. Resources are not evenly distributed. Growth rates are different. Budgetary and fiscal policies are different as well, with each government naturally doing what it finds best for its country's particular circumstances and with only some regard for the interests of the Community as a whole. Clearly if the new European Monetary System is to be, in the words of Bremen, durable and effective, it must take account of the economic as well as monetary circumstances of each member state and be matched by a still greater effort of co-ordination on the part of member governments than any have been willing to attempt in the past. The Commission has made a series of proposals for such co-ordination, and has emphasised — as I do again today — the need for such co-ordination to be seen in the framework of an eventual economic and monetary union.

Strengthening the weaker members

This general point was fully emphasised at Bremen. The specific argument which has since arisen is over the phrase then accepted which said that there would
be “concurrent studies of the action needed to strengthen the economies of the less prosperous member countries”, all put clearly in the context of the European Monetary System. This is obviously of crucial importance to those countries which are less prosperous, and I betray no secret if I place in this category Ireland, Italy and the United Kingdom. What action should be taken to strengthen the economies of these countries is still under lively discussion. Some have talked of the need to produce a more rational transfer of resources inside the Community than arises out of such existing Community mechanisms as the Community budget and the Common Agricultural Policy. Others have spoken of the need for extension and reinforcement of such Community instruments as the Regional Fund and the Social Fund. Yet others have spoken of special loans at favourable rates of interest arranged through the European Investment Bank or other mechanisms. None of these questions is settled. The debate about them has opened up some pretty fundamental questions about the functioning of the Community and the equity of its present mechanisms. This is all to the good. But I think we all recognise that problems of this magnitude cannot be fully settled with a speed sufficient to meet the stringent time-table — desirably stringent — for the setting up of a European Monetary System. But settled they must be if we are to have a Community which genuinely represents the common interests of member states.

Interests differ within Community

Before concluding I want to underline one fundamental point. The interests of our member states are not in all cases the same. There is, for example, an obvious temptation for the existing members of the snake to conceive of a European Monetary System which would in many of its essential be no more than the present snake writ large. There is another temptation to which my own country of Britain is subject: to see the system as yet another continental entanglement conceived in the interests of countries whose economic performance and problems are different from their own. My answer to those who would like the system simply to be a super snake is that it would simply be unworkable if it included. as it should, all or nearly all members of the Community. My answer to those who see it as a new entanglement in the interest of others is first that they should be less defensively suspicious (such suspicion has not served them well in the past); and second that if it should prove an entanglement it would mean that the system did not properly reflect the common interest and was for whatever reason badly designed. I appeal to all members of the Community to play a full and responsible part in the creation of a new institution in the interest of all.

Dangers of two-speed Europe

I now give a warning. If it turns out that all members of the Community do not feel able to join, at least at the beginning, and we are obliged to work out ways of squaring some very uncomfortable circles, then I foresee the real danger of the evolution of a two-speed Europe, or perhaps even of a three-speed Europe when the Community is enlarged. In such circumstances the very sense of a Community would be imperilled. A European Monetary System must be to the benefit of all and take account of the circumstances of all. Responsibility for failure would not necessarily rest only with those who felt unable to join. It would rest also with those who insisted over-much on setting things in a mould which fitted some well, some not so well, and others not at all.

EMS not directed against anyone

I conclude with a word on the international system of which the European Monetary System would be no more than a part. I repeat now what has been said many times before: that the European Monetary System is in no way directed against the international system nor against the US dollar. The health of the dollar is essential to the health of the international system, and we greatly welcome the measures recently taken by President Carter to strengthen the dollar. At the same time we must face the fact that the Bretton Woods system as we knew it after the war has broken down, and that we must gradually seek some new arrangements to take its place. No-one has suggested that the European Currency Unit should take the place of the dollar for which a leading role in the international monetary system remains necessary and unquestioned. But it is possible to envisage a system in which responsibility is more widely shared and in which both the European Currency Unit and of course the Japanese yen play a more important part. This is to look further ahead than is perhaps now easy to do. Today I want simply to emphasise that we live in one interdependent world and that what we plan for Europe must from the beginning be seen as something which does not conflict with but assists the interests of the world as a whole.

Editorial note

The main characteristics of the European Monetary System, proposed by France and the Federal Republic of Germany at the Bremen European Council, were outlined in an article which appeared in the Newsletter, No 77, of 12 July 1978.