european community
BACKGROUND INFORMATION

EUROPEAN COMMUNITY INFORMATION SERVICE
2100 M Street NW, Washington DC 20037 Telephone (202) 872-8350
New York Office: 277 Park Avenue, New York NY 10017 Telephone (212) 371-3804

BACKGROUND NOTE

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PROSPECTS FOR MONETARY INTEGRATION IN THE EC

Following is the text of an address delivered by EC Commission Vice President Wilhelm Haferkamp before the German Bankers' Convention, March 12, 1974, in Bonn, Germany. Haferkamp is responsible for European Community monetary and economic integration.

1. Introduction

It is not easy under the present circumstances to talk about "Prospects for Monetary Integration in the European Community." Public opinion is agreed that Europe is in a sorry state at present.

Today, the European Community stands at the crossroads. The events of the last few months and the behavior of the governments of the member states have disappointed many hopes. In retrospect, one wonders whether all those who made solemn declarations about economic and political union were prepared to draw all the consequences therefrom. Indeed, it seems doubtful that the governments of the member countries have the will and the courage to progress further on the road towards European unity and in particular towards monetary union.

In my opinion, there can be no doubt about the ultimate aim of achieving monetary union and its necessity, although the appropriateness of the methods and techniques used up to now, can be questioned. Today, European unity in the monetary field is important and urgent as never before, but if we are to succeed, we must reconsider the formulas and procedures and adjust them to the changed situation.

In my address today I would like to outline some ideas and proposals before this distinguished audience of experts. Perhaps in the past we have too often evolved theories on the drawing board. Perhaps we have had too few discussions with bankers and those concerned with practical affairs.

But we must ask ourselves first of all: were the means and objectives of monetary integration in the European Community wrong? What were the causes of the setbacks and failures?

2. Aims of Economic and Monetary Union

A) Any realistic analysis of the situation must begin by examining the objectives which the Member States fixed at the beginning of 1971, and which they have continually reaffirmed.

Firstly: the Community is to progress by stages towards economic and monetary union, and this should be completed before the end of 1980.

Secondly: progress in the fields of economic and monetary policy must proceed in a parallel manner.

Thirdly: the Community's organs must acquire the decision-making authority requisite to the administration of an economic and monetary union.

B) The final objective of economic and monetary union was firmly and clearly defined in the Council Decision of 21 March 1971. The aim is to establish an integrated economy among all member countries in which there is free movement of goods, services, capital and persons, and in which they are subject to the same regulations. To achieve this aim, an independent monetary area in which there is a common central banking system must emerge within the framework of the international monetary system.

The purpose of monetary cooperation is to eliminate parity changes and to narrow the width of the bands within which the value of Community currencies can fluctuate. In this way, the conditions for the introduction of a common European currency would be fulfilled.

3. Initial Experiences in Monetary Integration

A) The final objective of monetary integration is undisputed, and, moreover, in spite of all the difficulties, some progress towards this goal has been achieved.

In 1972 the member states agreed on the creation of a European monetary system, the so-called "snake in the tunnel," which made an important contribution to European monetary stability. In this way, the first steps were taken towards the creation of an independent European monetary personality. This strange animal, the "European snake," functioned by means of a network of agreements, multilateral interventions in Community currencies and dollars, short-term credits and rules for the periodic settling of debts between central banks.

In March 1973, the "European snake" was able to function as an effective implement of defense against the influx of dollars and against inflation, as Community currencies floated against outside currencies. Within the Community this system assured relatively stable exchange rates, as fluctuations in the spot rate of Community currencies was not allowed to exceed 2.25 per cent. In addition in the context of this European monetary "bloc" some early successes in harmonizing national money and credit policies, and particularly interest-rate policy, were achieved.

B) However, no progress was made towards liberalizing capital movements or harmonizing the capital market policy of the member states. On the contrary, during the first stage, controls on capital movement within the Community were increased. It was only recently in the aftermath of the oil crisis that some countries have moved to loosen controls on the importation of capital.

C) Finally, present plans for the achievement of economic and monetary union envisage consultation and endeavors to coordinate as the most important means of harmonizing economic and monetary policy in the member states.

But reality has proven to be quite different.

Consultations which were to be obligatory, above all in connection with adjustments in exchange rates, seldom took place <u>before</u> the actual decision was made. In many cases, the other partners could only take note of what a member government had already decided.

4. Current Prospects

A) The creation of a monetary area composed of the nine member states together with Norway and Sweden, and possibly including Austria and Switzerland, would have meant that 70 - 75 per cent of the foreign trade of these countries would have taken place at relatively stable exchange rates. This European monetary area has not come into being.

Today we are faced with the fact that instead of moving towards this monetary grouping, the present monetary situation is characterized by a tendency to disintegrate into national units. Today only five member states -- Belgium, the Netherlands, Luxembourg, Denmark, and the Federal Republic -- and two non-EC countries, Norway and Sweden, are still participating in the EC bloc floating.

B) The intensification of monetary integration as part of the economic and monetary union was planned for 1974. With the transition to the second stage the tasks and resources of the European Fund for Monetary Cooperation, founded in 1973, were to be increased. The system of short-term credits was to be transformed and expanded and the first steps towards the pooling of Community monetary reserves taken.

In addition to this, real progress was to have been made in coordinating external monetary policy and domestic money and credit policies, as well as in other fields of economic policy. It was realized that exchange rate adjustments could not be excluded in the transitional period, but they were to occur only after consultations among the participants. Finally, the Community was to act as a unit in its relations with the outside world and to be represented by a single speaker in international negotiations and bodies.

C) In negotiating the proposals for the second stage of Economic and monetary union it became clear that compulsory consultation and coordination procedures had no chance of being accepted. The majority of the governments refused to limit the scope of national decision-making. Because of the lack of agreement on the size of the regional fund and the criteria to guide its use, the formal transition to the second stage of economic and monetary union has not yet been approved. substantive decisions, paving the way for the second stage, were nevertheless approved by the Council of Ministers on 18 February of this year.

If all the Commission's proposals, including that on the Monetary Fund, had been approved by the end of last year, this would certainly have made a useful contribution towards progress in monetary integration. Today there are doubts whether the member states are really prepared to harmonize their instruments of economic policy and ensure that there is a greater degree of convergence of economic policies in the Community. The Council again postponed its decision on the proposals for Community polling of currency reserves: it limited itself to requesting a report from the Committee of Central Bank Governors and the Monetary Committee before the end of March of this year on which it intends to take action before the end of June 1974.

D) The oil crisis and its financial and economic repercussions on the economies of the member states have once again put the Community to the test. Up to now it has not met this challenge. Different degrees of dependency and repercussions on prices, as well as varying balance of payments and employment situations, have further strengthened the tendency of the member states to follow a policy of "every man for himself" and "sauve qui peut."

As a result of the increase in the price of oil, the balance of payments of EC countries as a whole in 1974 will deteriorate by approximately fifteen to twenty billion dollars. The countries concerned have attempted to deal with this situation in different ways: some have tried to raise billions on the international capital market, to increase their swap agreements with the US reserve system, to make use of IMF credits, or to let their exchange rates float downwards. Others have liberalized capital import controls and pointed to their comfortable cushion of large foreign exchange reserves. Instead of working out joint strategies to overcome the crisis, everyone is looking for national advantage. Instead of acting together, everyone is betting on national economic and monetary policies.

5. The Causes for the Deadlock and Setbacks in Monetary Integration

A) The picture of the present situation and prospects for European integration is a gloomy one. The possibility that monetary disintegration will continue cannot be excluded.

It is therefore even more important to ask the question: Has the road toward economic and monetary union begun in 1971 become impassable? Were those the wrong concepts and methods for achieving economic and monetary union? What caused things to go astray?

B) The first reason has become clear today. We began monetary integration in Europe too late. As long as the Bretton Woods system continued to function, monetary unity was certainly important but only a long-term aim of integration efforts.

First of all we wanted to harmonize the instruments and objectives of economic policy and initial structural conditions. First, the policies of the states and of both sides of industry were to be harmonized.

The creation of an independent European monetary system and a common currency would then have been the crowning accomplishment in achieving European economic unification.

Now we know that we have lost a lot of time. I hope not irretrievably! Today the problems now present themselves differently. We now need economic and monetary union to call a halt to the continual destruction of the international monetary system and to serve as a rallying point for forces pushing for the creation of a new monetary order.

C) The second reason for the unsatisfactory functioning of the European monetary arrangements as they presently exist is that there has been insufficient coordination of economic objectives and instruments.

So long as there are differences in economic priorities, so long as one country regards economic growth as of paramount importance and another sees price stability as crucial, and so long as cost and price trends differ, there will be disequilibria in the balance of payments which will make exchange rate adjustments necessary. If real progress towards economic and monetary union is to be achieved, then the objectives of economic policy must be made compatible, the instruments at the disposal of the member countries must be harmonized, and finally the objectives fixed by common accord must be implemented and the member states must jointly accept responsibility for them.

To achieve greater convergence of economic trends and of policy goals and instruments also necessitates harmonization of the different basic social and regional structures. This means that those countries having a sound economic structure must aid the weaker partners and regions, in other words that a European adjustment mechanism extending to agricultural, social, and regional policy must be created. A condition of providing aid for others is however the right of all to participate in formulating and implementing policy.

D) The <u>third reason</u> for the failures in economic and monetary integration is to be found in the lack of decision-making structures at the Community level. Consultative bodies and non-binding procedures are insufficient to impose joint action. The harmonization of the central objectives of short-term economic stabilization and employment policy in the member countries will not be accomplished by consultation. Rather, it is necessary to transfer national powers step by step to Community organs and in this way to put the objectives of economic, monetary, and foreign policy fixed by the Community <u>into practice</u>. The challenges of the present energy crisis show painfully how little the Community is presently capable of asserting its political and economic strength.

But it is precisely at this point, when it comes to renouncing national sovereignty, that all Governments shrink back and refuse to admit to themselves that they have already lost part of their national autonomy as a result of the high degree of economic interdependence. Even without the energy crisis at the end of 1973 it would have been impossible to overlook the fact that for more than a year the Council of Ministers had been putting off virtually all important decisions. The real reason for this situation is fear of the politico-institutional consequences which an effective policy at Community level would entail. The gap between the declarations of intent by politicians and the actual progress achieved is growing ever wider, and the credibility of the integration aims continually smaller.

6. <u>New Ways to Achieve Monetary Union</u>

A) It must be emphasized here once again that we cannot abandon the goal of economic and monetary union, even if we must find new methods to achieve this. A common market requires a common and stable basis for calculating the costs of trade, and planning production and investment. Without this, there is a continual danger of a retrograde development and disintegration.

The Common Market is only viable in the long run if it proceeds to develop further into an economic and monetary union. Otherwise there is a danger that it would regress into a free trade area. The dismantling of the Common Market could well take place faster than one might imagine today and under these circumstances we would no longer need to concern ourselves with European integration.

We are therefore faced with the question of how we now intend to achieve this final objective of economic and monetary union.

B) The European Community plays a decisive role in the world economy. It must therefore assume a corresponding responsibility for the orderly functioning of the world's economy, a duty which will be all the more crucial if the international economic system threatens to disintegrate. We have been able to put this off for a long time because the Bretton Woods agreement functioned tolerably well, but today swift action towards monetary cooperation is imperative.

The Commission must give priority to progressing towards economic and monetary union. That may sound Utopian, but in reality it is the alternative Utopian: that is, in other words, to wait until the "20" or "30" have agreed on a new world monetary system. If we wait any longer we are in danger of gambling away the results of European integration, the unification of the markets of the member states.

But what can we do?

C) In my opinion the Community must realize three things:

Firstly: with the disappearance of the worldwide monetary order we in the Community need a new method of integration. Up to now we have worked towards the integration of markets, sectors, and regions. Now we need in addition to these endeavors a new agent of integration in the form of monetary unification.

Secondly: monetary integration has -- contrary to appearances -- a good chance of success, if it becomes less committed to finding ideal institutional and procedural solutions than previously: Plans for economic and monetary union have up to now been largely conceived on the theoretical level, with little attention to practical realities.

These plans lacked sufficient links with the market, banks, and entrepreneurs which already operate on a European scale extending across national borders. The present dangerous situation requires that central banks and the major commercial banks must coordinate their activities on a European level more than hitherto. Theoretically conceived plans and timetables must be replaced by a permanent coordination of behavior -- a European monetary dialogue -- with the aim of achieving a common monetary policy towards the rest of the world.

Thirdly: structural and regional policy -- which have already been mentioned -- must also get away from idealistic theoretical models. We need a liberalized European capital market to even out differences in productivity and to correct structural problems. The planned European Regional Fund would be hopelessly overburdened if it were supposed to achieve this by itself. Indeed, one of the essential reasons for the epic struggle of politicians may also be found in this misconception of the Fund's tasks. Our aim should rather be to mobilize European capital markets to meet this challenge; to end the days of Europe being merely a center for the distribution of foreign capital.

D) Above all the member countries must now face together the pressing danger of a further disintegration of the international monetary system. In view of the uncertainties in the monetary situation and the imminent changes in balance of payments conditions in the industrial countries, it would not be a disaster if we had to live for a longer period with floating exchange rates. It would be a disaster only if our exchange rates were to increasingly fluctuate in response to the investment preferences of the oil producers. We must therefore establish some order among these flexible exchange rates by means of a mutually coordinated policy. It will take some time before this happens within the framework of international monetary reform. In the meantime, close monetary cooperation between the EC and the most important industrial states, above all with the United States, is essential. This kind of concerted effort, which would also be directed towards cooperation with the oil-producing countries, could make an important and stabilizing contribution to international monetary relations. And that would be in everyone's interest.

A glance at events in the monetary field in 1973 show how necessary this is. Since May 1973 for example the value of the dollar in terms of the currencies of the European float has fluctuated by more than 20 per cent, only to return at present to its level of March of last year. This instability was neither in the interests of the United States, of other industrial states, nor of countries producing raw materials. The consequences of the rise in oil prices and continuing speculation in gold lead one to fear that this monetary instability will continue. For this reason, it is vital that the exchange rates between important trading partners should no longer be subject to arbitrary changes and exaggerated movements. This necessitates a more comprehensive system of rules and agreements than before.

Cooperation between the EC and the United States, as well as any other interested party, in the field of monetary affairs, could ensure a minimum of international monetary order and minimize the risk of a world-wide recession as a result of the cumulative effects of "beggar-my-neighbor" policies. Such a contribution to stability would also make it easier for the countries floating individually to maintain a sensible exchange rate. The experiences of 1973 pointed to the fact that undisciplined floating has tended to increase domestic inflationary tendencies and to promote speculation in raw materials.

7. Conclusions

It would be wrong to prophesy the collapse and disintegration of the European Community. But the member countries must not only combat the continuing weakening of the Community; they must also come to regard the Community as one of the last pillars which must not be allowed to collapse, if they are to continue to enjoy a minimum of monetary stability. Progress towards the realization of economic and monetary union is, however, also a positive contribution towards the re-establishment of orderly monetary and commercial relations in the world.

A Community which is economically so very dependent on the rest of the world must necessarily have a fundamental interest in a stable world economic system.

Setbacks with domestic economies too or even a standstill on the road towards monetary integration in the Community would bring dangers and risks for all member countries. There is no alternative to the economic and monetary unification of Europe. Disintegration and the retreat into national solutions would have economic, social, and political costs which no member state could afford to pay. There is therefore only the road forwards towards an economic and monetary unity in Europe.

The governments of the member countries do not have much more time in which to meet this challenge. The political and economic forces in the world are in the process of changing, and Europe will no longer be able to play a role if the European states continue to try and solve today's problems with yesterday's ideas and instruments. The opportunity and the need for a new beginning are present in the challenge of creating a European monetary union using new and unconventional methods. Whether we make use of the opportunity depends not least of all on <u>you</u>.