# Statement by Pierre Werner on the fight to curb inflation (Luxembourg, 19 May 1973)

**Caption:** On 19 May 1973, Luxembourg Prime Minister, Pierre Werner, emphasises the importance, for Luxembourg, of European monetary union as a tool to combat inflation.

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It is generally agreed that inflation currently represents the most serious threat to the European Community's economic policy. Beyond the confines of the Community, most industrialised nations are affected. Like La Fontaine's plague-stricken animals, they are not all dying of the disease but they are all suffering from it.

Governments are surprised that efforts to control it have had no effect. It looks as though an international strategy will have to be devised to deal with the situation, which is a direct result of the openness of modern economies based on free trade in goods and services. What is true in a wider international context, is also true *a fortiori* in the Community. It is here that the increasing interpenetration of national economies has done most to weaken individual countries' autonomy in the area of short-term economic policy. This loss of control has not been adequately offset by the introduction of Community policies. By and large, economic operators have adjusted to the paraphernalia of a common market (even the advent of multinational companies, the euro-currency market, and cooperation in the industrial and banking sectors), but political and regulatory measures have been slow to follow.

It seems the battle against inflation cannot be won at national level. The framework is too narrow. However, while recognising the need for close cooperation in Europe and beyond, it would be a mistake to expect miracles overnight. A community of states can pursue inflationist policies just as well as an individual nation.

The most important political question is whether we want to build a stable community that will promote orderly growth by maintaining the purchasing power of the currency at a reasonably constant level, or form an economic conglomerate where the currency is in a state of perpetual erosion, with consequent social tensions and economic decline.

There are many reasons for the alarming increase in inflation. Some are familiar from long experience, but others are more subtle, arising from changes in political and social behaviour.

It is not for me to examine the various causes of the present inflation. There are conventional inflationary events such as balance of payments deregulation and excessive expansion of liquid assets and credit. I would only say that, quite apart from these, the social and economic environment has changed, and any action to combat inflation must take this into account. These, briefly, are the principal contributing factors:

— The monetary fiction based on the nominal identity of a monetary unit now plays almost no part in the process of determining prices and wages. Producers and consumers think in terms of relative prices and realistically make allowances for actual or likely increases at the outset.

— Generally speaking, the various private and public economic operators' anticipatory measures and future projections contribute to a cumulative process of forward estimates. Social security systems now offer much wider protection against life's hazards, with the result that the volume of voluntary saving is determined to a greater extent by price trends and a tendency to seek instant gratification.

— No government can afford an increase in unemployment. Accordingly, structural changes in production are often curtailed and adjustments delayed.

— The automatic adjustment and alignment of prices and benefits make consumers less willing to fend for themselves.

This list shows once again the complexity and difficulty of the task we face. The causes are universal and call for concerted thought and action.

Stability requires either strong government or an untarnished political ideal. It would seem that it can really be achieved only within a new framework, where mundane concerns and conflicts of interest are transformed into a new objective of economic synthesis. In the case of the EEC, this means monetary union.

The aim to which the Community aspires is economic and monetary union, ensuring growth, employment and stability. It is sometimes difficult to reconcile these three objectives, but the Community, given the necessary powers, is in a better position to maintain a balance between them than any individual state at the present time. I would remind you, first, that, with a view to monetary union, the Community's overall balance of payments is in credit *vis-à-vis* the outside world. Its economic potential is broad-based and highly dynamic, thanks to free competition, so it has a good chance of achieving and maintaining an overall balance, while at the same time imposing the necessary discipline on the Member States. Within the Community, the idea of union involves the balance between the national economies being maintained by mobility in the elements of production and financial transfers from both public and private sectors.

In the course of the coordination and harmonisation of the various policies that determine the overall balance, it should be possible to identify the strengths and weaknesses of the national economies and so devise Community policies that are more objective, show greater cohesion, and produce more rational results. The Community card must not be misused, but it will sometimes serve to overcome selfish and short-sighted attitudes with assurances of solidarity and mutual assistance. Of course, everything depends on the political will, the quality and the competence of those who set out the basic guidelines to be followed. But we shall have what we need for a policy of stability if the Member States make up their minds to carry the programme through without flinching.

I should like to review the principal lines of action recommended in the report from the group which has drawn up the programme for economic and monetary union, and in the Council resolutions of March 1971 and 1972, and draw attention to the priorities to be borne in mind with regard to the action undertaken in the near future.

**General economic policy**

Medium-term quantitative objectives must be set for growth, employment, prices and the external trade balance, with due account being taken of the economic situation in each country. As regards conjunctural or short-term policy, the plan is to draw up mutually compatible prescriptive economic budgets. In the interests of efficiency and discretion, the Council has set up a special group to facilitate the coordination of short-term policy. It will be responsible, in particular, for preparing the three annual sittings devoted to a consideration of budgetary and short-term economic policies, culminating each year in a general report on the economic state of the Community.

During the first stage, these attempts at coordination have produced only moderate results. There is, certainly, a time-lag between the opening up of the various economies and the economic operators' spontaneous reactions to this state of affairs, on the one hand, and moves by the competent authorities to control the economic situation by adopting appropriate measures and directives, on the other.

Furthermore, the quantitative targets repeatedly set by the Council on a proposal from the Commission have been attained on only a few occasions. The failure to do so is attributable to differences in the structures and economic cycles of the various Member States. The Paris Summit in October last year therefore emphatically insisted that the coordinated overall policy must be supplemented by appropriate regional, sectoral and social policies. A greater united Community effort seems to be needed to deal with the employment problems associated with regional development in particular. In this connection, rules must be devised for automatic adjustment and assistance to overcome temporary difficulties in some Member States, and they, in turn, must take any internal corrective measures required to deal with the situation. In this way, it will be possible to avoid changes of parity between currencies within the Community, although they will continue to be allowed until the final phase of full monetary union begins.

The decisions to be taken in connection with the coordination of short-term policies must be informed and guided by medium-term quantitative forecasts. In connection with the preparation of these forecasts, appropriate procedures will have to be devised for consulting those involved in the economic process, notably workers and employers, and for associating them with the policy to be pursued. This is a particularly delicate and important point. The whole policy must be so designed as to avoid demand- and cost-driven inflation.

**Financial and budgetary policy**

National budgets play an extremely important part in expanding or restricting demand. It is therefore recommended that common standards be established regarding variations in the volume and extent of borrowing, arrangements for financing deficits and the use to be made of any balances.

The problem of borrowing requirements is a crucial factor in monetary and budgetary policy. Monetary union does not prevent states from allocating their budgetary resources as they wish, it does not require uniform levels of taxation or even complete unification of credit methods. However, in order to secure equal opportunities for all and protect the purchasing power of the common monetary system, it does require monetary arrangements to be established in accordance with strict and closely coordinated rules, in the interests of public expenditure and, more particularly, investment.

Upper limits must be set for financing budget deficits in the short term. Member States must also make the necessary legal arrangements to enable them to respond quickly to the demands of short-term economic policy. The practice of drawing up contingency budgets, appointing fiscal regulators and keeping economic contingency reserves will enable policy to adapt to sudden changes in market conditions.

The Community’s internal stability will, of course, depend primarily on the ways in which liquid assets are generated in the area as a whole. That is why the creation of these assets, monetary policy and credit policy must be centralised.

The natural corollary of the process set in motion by the European Monetary Cooperation Fund is a Community system of central banks, empowered to set the general pattern of internal monetary policy on fluid interest rates and public and private sector borrowing.

The policy of introducing successive restrictions on the Community currencies’ fluctuation margins and, eventually, abolishing them completely is important for the safe conduct of business. It calls for measures to secure mutual financial support and correct and adjust policy failings, and these will, in turn, lead to increased cooperation and cohesion between Member States.

Community procedures will increasingly have to be devised to deal with any changes in exchange relations that may still occur during the transitional period.

**External aspects of monetary union**

We must not forget that some of the causes of inflation lie in the deregulation of the international monetary system. European monetary union can make an essential contribution to the sound management and consolidation of the new system now under consideration in the Group of Twenty. The idea is to get rid of the special advantages enjoyed by national reserve currencies and establish the monetary system on a body of reserves specifically set up and defined by the global community. This collective currency must be managed with the utmost rigour and objectivity, in order to ensure that its conduct does not generate further waves of inflation. As with any currency, its value will ultimately depend on whether it is convertible into the principal currencies in which world trade is conducted.

The European monetary system should be one of the main pillars of this monetary structure. But it cannot fulfil that role if it does not exist. In other words, the Community’s monetary personality must be asserted and imposed if it is to exert an influence.

At this point, the question arises whether the Community would carry more weight if European countries which are not members of the EEC were to be associated with the work of coordination and joint action within the common market. My own view is that that would be highly desirable. A monetary system undoubtedly includes arrangements for varying degrees of association. In view of the political aspects of closer cooperation, the status of associate members will be subject to certain limitations with regard to the application of Community agreements. However, it is patently obvious that any extension of the basis and scope of European monetary union is likely to strengthen its action at global level.

**Conclusions**

I have tried to answer the question whether the solution to inflation lies in European monetary union. I think that I have proved that it does and that monetary union is a political necessity.

Basically, monetary union can fulfil this role only if we are determined, in all the Member States, to pursue a policy of stability and equilibrium. If we are so determined, we shall promote the policies and find the means to achieve the objective.

To sum up:

1. The Community as a whole has to ensure that its overall balance is in equilibrium with the rest of the world.

2. To achieve balanced development within the Community, the Community bodies must encourage overall coordination of economic policies, mechanisms for internal transfers and for redressing the balance by means of specific policies on regional development, employment insurance, sectoral reorganisation and social progress.

3. Community guidelines on the Community's overall liquid assets are needed, and the instruments of monetary policy must be harmonised to that end.

4. The Community must be able to state its case and exert an influence at global level.

Of course, the Community's institutional framework will have to be substantially strengthened if it is to carry out this programme. But that does not mean that we can afford to drag our feet and hesitate about what course to take. We face a challenge in the monetary sector. The only remedy is to move rapidly forward. Every country will have to conduct its own campaign at national level, but it is clear from what I have said that the EEC Member States also have it in their power to defend European purchasing power and monetary order in the world by resolute application of the programmes set out at the Conference of Heads of State or Government held in October 1972 and the resolutions already adopted, or shortly to be adopted, on the establishment of economic and monetary union.