‘The politics of monetary union' from The Financial Times (16 November 1970)

Caption: On 16 November 1970, some days before the meeting of the Council of Ministers of the European Economic Community (EEC) on the proposals in the Werner Report, the British daily newspaper The Financial Times provides a detailed analysis of the plan to establish a European economic and monetary union.

Source: The Financial Times. 16.11.1970. London: The Financial Times Ltd. "The politics of monetary union", auteur:Samuel Brittan.
Archives familiales Pierre Werner, Luxembourg.

URL: http://www.cvce.eu/obj/the_politics_of_monetary_union_from_the_financial_times_16_november_1970-en-3a827041-c201-4765-b94a-dd4dfeca87a6.html

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NEXT MOVE OF THE EEC

BY SAMUEL BRITTAN

The politics of monetary union

M. Pierre Werner

THE PROJECT for a European economic and monetary union has a great aura of mystery about it. While most people interested in the question of British membership of the EEC are aware of the problem posed by agriculture—so well symbolised by the price of butter—economic and monetary union is much more nebulous and esoteric.

There is little doubt, however, that the opponents of EEC membership are going to play up its political implications in a big way. Moreover, the first practical steps will be taken next year in the shape of intervention by EEC Central Banks to narrow the margin of fluctuation of their currencies against each other. Thus the issue is no longer possible to ignore.

The project began with a summit meeting at The Hague at the beginning of December, 1969. It was then agreed to draw up a plan for the creation by stages of an "economic and monetary union." How far the heads of Government realised the implications of what they were doing is debatable. It may have seemed a technical subject on which an impressive agreement of principle could easily be reached without too much obvious embarrassment or effort.

In any case, the Brussels Commission and the enthusiasts for monetary union in member countries used the communiqué for all it was worth. Despite considerable scepticism within many EEC Central Banks and Finance Ministries, the project developed a momentum of its own. The Council of Ministers accordingly asked M. Pierre Werner, the Luxembourg Prime Minister, to draw up a report.

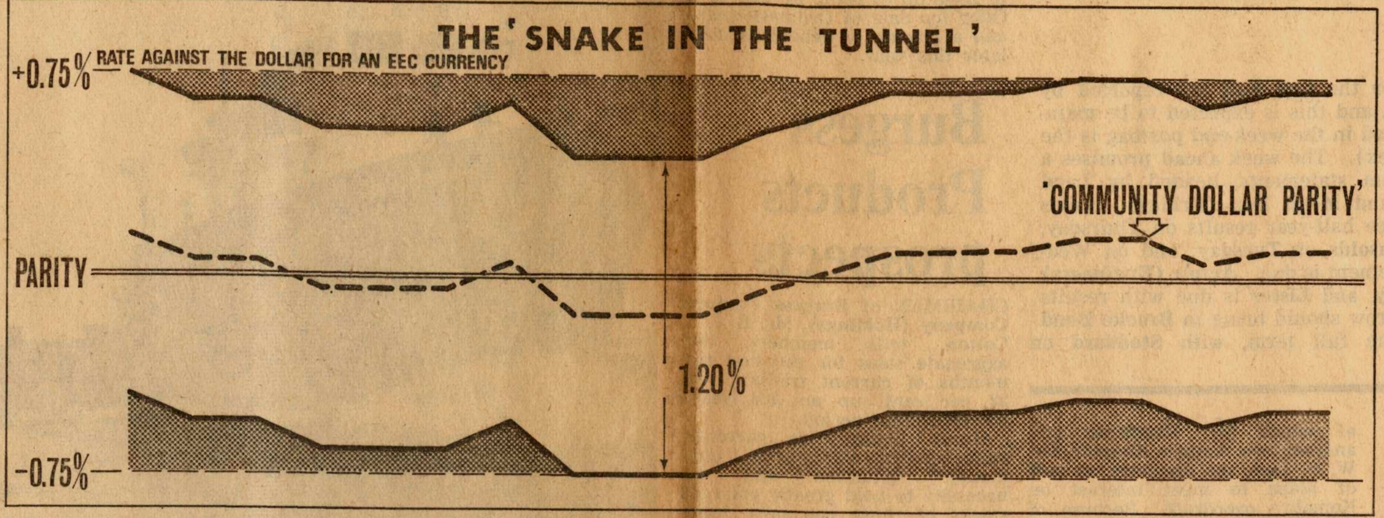
The report will be discussed by the Council of Ministers on November 23 and December 14. The French Government, which was originally keenest on the idea has expressed reservations on some of the supranational aspects; and the Commission itself has made some suggestions for toning them down. Nevertheless, proposals based on the report are likely to be adopted.

The official aim of the Community is "economic and monetary union by 1980." This is a highly ambitious objective involving the irrevocable freezing of exchange rates between member countries, the complete freeing of all monetary and capital movements and the abolition of all customs frontiers resulting from different indirect tax rates. If achieved, the EEC would have, to all intents and purposes, a common currency, and a common economic policy.

Difference

The Werner Committee was dogged by a difference of principle between the Germans and Italians who stressed the harmonisation of economic policy, and the French and Belgians who stressed monetary unification—which means in effect more rigid exchange rates. The "economic" school of thought stressed that a monetary union could not hope to work if there were widely different rates of inflation within the EEC leading inevitably to currency readjustments. The monetarists, on the other hand, argued that a locking together of exchange rates was essential to provide an incentive to the harmonisation of economic policy.

Behind the theology there were political interests at stake. The Germans disliked the idea of an exchange rate régime under which they might be in chronic surplus and thus have to choose between importing inflation and providing continuous economic aid for their partners. The French—who have changed their exchange rate more than any other country—felt that the Common Agricultural Policy was more likely to survive in a régime of rigid parities.



How a Community currency may move against the dollar.

The Werner Report was, predictably, a compromise. Economic harmonisation and monetary unification are supposed to march hand in hand. The specific proposals on which Ministers are asked to agree are for the first three-year stage to begin on January 1, 1971. The Council of Ministers will during this stage be expected to meet at least three times a year to agree on a broad outline of economic policy for the whole Community.

Community recommendations will be especially precise on budgetary matters. Guidance will cover the size of public expenditure in each country, the size of the budget deficit—if any—and how it is to be financed. Members will aim to standardise financial years, bring together their methods of budgetary presentation and adopt similar tax regulators to cope with inflation or recession. There will also be a programme for reducing differences between the rates of Value Added Tax and for the elimination of troublesome differences between excise duties.

One can argue that a great deal of this may never happen. Countries can ignore advice. Indeed, many of the suggestions for freeing capital movements have been previously accepted in principle without much result. Nevertheless, the machinery of budgetary guidelines amounts to a degree of mutual surveillance never before attempted in, say, the IMF or OECD. However tactfully the recommendations are phrased, the sheer labour of dealing with the mountains of paper and figures will tend to make the Community documents figure prominently in policy discussions within each separate Government machine.

The one area where member countries are committed to definite action is in narrowing exchange rate margins. At present each Community currency is fixed against the dollar and it can move by up to 0.75 per cent. on either side of its official parity. This gives a total band of 1.5 per cent. against the dollar, but of 3 per cent. between one Community currency and another.

Ingenious

The Committee of Central Banks has come up with an ingenious method of narrowing this band. A "Community dollar parity," will be fixed, based on a weighted average of the premiums and discounts prevailing in each member country against the dollar. Each Central Bank will intervene to narrow the margin of fluctuation against the dollar—the present working hypothesis is to 0.6 per cent. This would give a 1.2 per cent. band around the dollar and a 2.4 per cent. band around the EEC currencies.

The beauty of the scheme is that margins within the EEC can thus be narrowed without any intervention in currencies other than the dollar and without mutual support by EEC Central Banks—although these other features are expected to arrive before the end of the initial three-year period. The possible movement against the dollar will be narrowed on any one day. But the movement of the "Community dollar parity" will ensure the continuation of the existing band over a period of time. The scheme is well described by the metaphor of a snake crawling in a tunnel. The German Economics Minister, Professor Karl Schiller, has several times called for consultations with the U.K. in implementing the plan, and this will almost certainly happen, at least informally.

For all its ingenuity, the plan for narrowing margins within the community really matters only as a symbol. Existing margins are too small for advocates of flexibility to mourn their loss within the EEC. There may, however, be some technical interest in the fact that the EEC Central Bankers have stumbled almost by accident on a formula for a "moving" or "crawling" band of European currencies, against the dollar. With a band of only 1.5 per cent. against the dollar, the amount of flexibility is extremely small. There are however some Continental monetary experts who believe that the existing IMF Articles could one day be stretched to permit a 2 per cent. margin—and therefore a 4 per cent. band—against the dollar. This would still be small, but at least a beginning.

The Werner Report makes it clear that parity changes within the Community will not be "totally excluded" until the final stage of monetary union—1980 at the earliest. Once this is accepted, there seems no reason why exchange rate adjustments should not be, according to the Italian formula "small and timely" rather than large, delayed and disturbing. The Brussels Commission will dispute this, but its words are not yet Holy Writ.

Controversial

It may seem a little odd to devote such efforts to narrowing exchange rate margins among EEC countries so long as the parities around which the fluctuations take place can themselves be shifted at any time. Indeed, the main importance of the scheme is that agreement on it might pave the way for a common front in the IMF discussions on flexibility and other issues which hitherto have been held down by disarray within the Community.

Clearly, the plan for narrower margins does not allow for floating—as distinct from flexible—exchange rates. A floating pound could, however, be justified (a) as a preliminary step to get the right sterling rate before entry and/or (b) as part of the early transitional arrangements. Although such a move would be controversial, I doubt if it would be a bar to membership if the British Government were really determined and there was agreement on other issues.

It would be wrong to leave the matter here without referring to the long term goal. Two opposite mistakes are to assume that the EEC is irrevocably committed to monetary union and cynically to dismiss the entire project. Monetary union and a common currency imply a common Budget, political union and some form of European Government. For some people this is the main attraction of the project; and for others it rules it out altogether. But for those who regard governments, whether national or international, as pieces of machinery to be judged by their effects on individuals, the problem is different. It is whether members of an enlarged Community would really be better off as a single currency area, or whether they would be better off with separate currencies.

This is very much an open question. But the worst of all worlds—into which the EEC is in danger of stumbling— is one where the machinery of monetary union is successful enough to put a spanner in the wheel of normal balance of payments adjustments via exchange rate changes, but not successful enough to make such changes unnecessary. The time has come for the British side to end its tactful silence and demonstrate its true Europeanism by making a contribution to the discussion.