Jacques Delors gives his views on the Werner Report (1992)

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MONETARY COOPERATION IN THE BUILDING OF EUROPE

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The 1992 Jean Monnet Lecture

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Jean Monnet
1888 - 1979

"Nous ne coalisons pas des Etats, nous unissons des hommes".

"The Father of Europe" was born in the French town of Cognac. After an early career in his family's brandy firm, he became an international civil servant (the League of Nations) and political economist (advisor to several East European governments in the interwar period).

From 1943 he was an economic advisor to de Gaulle and at the Liberation became France's first Economic Planning Commissioner - the author of the famous "Monnet Plan" for post-war reconstruction. A close collaborator of Robert Schuman, he inspired the "Schuman Plan" for the creation of the European Coal and Steel Community. In 1952 he became the first President of the High Authority of the ECSC. After his retirement in 1955 he became Chairman of the Action Committee for the United States of Europe.

Jean Monnet's *Mémoires*, published in 1976, have become one of the basic texts of the history of European integration.

In particular today I wish to congratulate the LSE on the setting up of two European chairs: the Jean Monnet Lectureship in European Community Politics and the Lectureship in the Economics of the European Community. I welcome the interest shown by the academic world in the process of European Integration. I find the time is ripe for an effective contribution from academia on the definition of the aims of Europe. Indeed, I myself make the time to meet and discuss with the scientific community on a regular basis. I wish you every success in your work upon which our future is based.

The LSE European Institute has also established an annual Jean Monnet Public Lecture with the object of increasing public knowledge and understanding of the policies and problems of the European Community. It is my pleasure to give the first lecture in what I hope will be a long and fruitful series.

Monetary Cooperation in the Building of Europe

I will devote my lecture to the subject of monetary cooperation in the building of Europe. I have chosen this topic for two reasons:

- first, because institutions have played an important role in monetary cooperation. Jean Monnet saw their importance also when he used to say that "institutions are the memory of the people";
- second, because monetary cooperation is essential to the economic progress of the European Community.

I do not intend this lecture as a great scientific contribution to economic and political theory in this field. Rather I wish to give you some thought on over two decades of monetary experience.

In my view, monetary cooperation alone cannot achieve progress unless it is accompanied by economic and institutional advances. With this thought in mind, I propose to look first at the history and lessons of the Community's first serious attempt at Economic and Monetary Union, the Werner Plan. Although both the monetary and the wider economic and political foundations were present at the outset, this plan was destined to fail because of problems linked to its economic motivation in the course of implementation. I shall then examine the progress brought about by the EMS and its limits. The EMS was founded largely on monetary concerns, although the success of the system has been to engender economic convergence. I shall turn to the plan for Economic and Monetary Union, which combines the monetary and economic sides in a wider institutional framework in order to overcome the limits of the EMS.

* Second, the mechanisms and procedures of monetary and economic policy coordination were not in place.

Politically, the Community was not as developed as it is now, nor were the perspectives for its development there.
* The Community was emerging from a period of political stagnation during the second half of the nineteen-sixties, during which it had regressed towards the intergovernmental grouping of nation states favoured by de Gaulle.
* The Community was coming to terms with its first expansion from six to nine members to include principally the United Kingdom, something which de Gaulle had consistently blocked.
* The political atmosphere in the major countries was inward-looking. The United Kingdom was involved in a rethink over participation in the Community, France and Germany had internal problems. The opportunity for developing cooperation was not there.

Economically, the Werner plan came at the worst possible time.
* Externally, the Bretton Woods international monetary system was falling apart. Under the pressure of the failure of the key currency, the US dollar, to act as a satisfactory anchor, other countries were beginning to go their own way. Speculative capital movements were causing turmoil on the exchange markets.
* The first oil shock at the end of 1973 saw prices quadruple in a period of months. It caused a period of intense balance of payments difficulties for Community Member States.
* Internally, the economic policy reaction of major Member States to the economic crisis was very different. The United Kingdom and Italy adopted strategies which resulted in high inflation as they attempted to avoid putting the burden of adjustment on households. In Germany, the Bundesbank in contrast kept its tight control of the monetary aggregates, moving indeed to monetary targeting in 1974. The French authorities adopted a middle strategy, which still did not achieve much exchange rate stability since they entered and left the Snake twice during the nineteen-seventies.
* In addition, economic integration of member States was much less than it is now. Capital movements were still tightly controlled, so that there was no prospect of a European financial market.

Behind diverging economic circumstances lay a profound debate among economists on the relative merits of fixed versus floating exchange rates. One

camp, led then by Robert Triffin, felt that the exchange rate was too important a price to be left open to the danger of overshooting and to the destabilizing influences of short term speculation. The other camp was made up of an alliance of liberals, who argued against any interference in free markets, and dirigistes, who saw in floating exchange rates the opportunity to be rid of the balance of payments constraint, thus allowing countries individually to pursue demand-oriented growth policies.

Part 2: Progress through the EMS and its limits.

The argument over fixed or floating exchange rates is still not finally resolved. However, within Europe the experience of the nineteen-seventies convinced some that, although the Werner Plan had failed, EMU should not be allowed to die.

The relaunch of monetary cooperation.

Here I must single out the vital contribution of Roy Jenkins, then President of the Commission. Through a speech made in Florence in 1977, he said, "Some commentators believe the time is unpropitious for adventurous ideas. I do not agree". He went on to say that, "we must now look afresh at the case for monetary union".

Roy Jenkins chose the right timing without which his proposals would have fallen on deaf ears. He had what Jean Monnet called "the feeling for the moment". The Community economy was growing, the political situations in Germany and France were more stable. The weak dollar made the need for monetary cooperation all the more evident.

He went on to present the case for monetary union with some economic arguments that are just as valid now as they ever were. It is worth recalling them shortly:

* monetary union favours a more efficient and developed economy;
* inflation would be brought down;
* employment would be increased through durable growth with monetary stability;
* a new European currency would counterbalance the dollar.

Monetary cooperation is important economically.

In fact Roy Jenkins was sumarizing the basic arguments for monetary cooperation. In a context of increasing economic integration, monetary cooperation and, in particular, the monetary and exchange rate stability that it brings can be seen as a public good. It is something once obtained that brings benefit to all economic actors. Stable exchange rates and low inflation reduce uncertainty. In an already uncertain business environment, this allows decisions to be taken more easily.

Just as important, a lack of monetary cooperation, resulting in currency instability, risks undermining the four freedoms of movement of goods, services, capital and persons that lie at the foundations of the Community.

The experience of floating.

These economic arguments were reinforced by the experience of floating.
Because of the failure of the Snake to produce anything beyond a very limited area of monetary stability, the major European currencies in effect floated against one another for most of the nineteen-seventies. The experience of floating and the exchange rate variations revealed the costs of chasing an apparent extra degree of policy freedom.

The result for the devaluing countries was not that economic adjustment was avoided. On the contrary adjustment was simply postponed and often made more difficult through the need to bring inflation back down.

For the economic health of the Community a lack of monetary cooperation was seen to be detrimental. Floating exchange rates discourage economic cooperation and obstruct market integration. In effect, economic integration was increasingly recognized as essential to achieving a better growth and employment performance.

Monetary instability undermines economic confidence. It can paralyse decision-making. It renders instruments of economic policy less effective. The more our economies become interrelated, the more this is true. Monetary instability increases the risk premium on investment flows and damages therefore the free movement of capital.

International monetary system.

As when Roy Jenkins spoke, the currencies of Europe remain dominated by the US dollar in the international monetary system. Moves in the dollar exchange rate have implications for the economy of the Community that go far beyond the simple effects on trade relations with the US. The Community is unable to counterbalance the dollar because of the diversity of its currencies. It is interesting to note that this and other initiatives aimed at bringing about closer monetary cooperation took place at times of dollar weakness when the strains on European currency stability tend to be at their greatest.

As for the Werner Plan ten years before and for EMU ten years later, the impulse for the creation of the EMS came from the highest political level. Giscard d'Estaing in France and Helmut Schmidt in Germany were strong enough politically in 1978 to put forward moves which prepared the ground for establishing the system.

The principles of the funtioning of the European Monetary System and their consequences.

The EMS is a system of fixed, but adjustable, exchange rates. The design of the EMS benefitted from the experience of the Snake. It improved that system in several ways.

* The ecu was created as a Community currency, a reference for the EMS
* A limited swap of reserves was implemented, thus mobilising some of the members' gold reserves into ecus
* A divergence indicator was set up to provide early warning of exchange rate tensions in a symmetric way.

Most importantly, the EMS represented a new start at efforts towards monetary cooperation. It was based on a political resolve which was never present at the time of the Werner Report, but its initial foundation was largely monetary.

The progress brought about by the EMS can be attributed to its own evolutionary characteristics that brought about advances on the economic side, thus allowing a stability constraint to progressively take hold. This is based on three principles:

* Stability and progressivity : EMS rules and procedures aim to achieve a compromise between the flexibility necessary in terms of realignments and the constraint in terms of the public commitment to stability-oriented politics.
* Co-responsibility : The system is built on an explicit coordination of monetary responsibilities in that exchange rate realignments must be decided by mutual agreement.
* Financial solidarity : the financial support mechanism provides an aid for countries to undertake economic adjustment. The mechanisms range from the unlimited very short-term finance available for interventions to the medium-term financial support of fourteen billion ecus. The latter is available under certain economic conditions to alleviate balance of payments problems.

These principles are mostly monetary in character, but the consequences of the way the EMS has put these principles into effect have reinforced the economic side.

* Economic policy coordination has increasingly come to be seen as the key to exchange rate stability. This contrasts with the experience of the Snake and of the 1974 Convergence Decision which was applied more in form than in substance. This has helped countries undertake necessary adjustment measures in an orderly fashion;
* The role of the Deutschmark as the stability anchor for the system has steadily grown. Although this is one asymmetric aspect that is due to change in Economic and Monetary Union, the anchor represents, for the EMS, a dynamic compromise with mutual gains:
    - weak currencies buy the credibility of the Bundesbank. This exerts a downward pressure on inflation while limiting adjustment costs;
    - strong currencies benefit from a real depreciation and from international seignorage.
* Markets validated the progress made in the direction of monetary stability in developing the use of the ecu far beyond its limited role in the EMS.

These consequences have progressively taken hold over the years that the EMS has been functioning. For example, over time realignments have come more and more to be multilateral agreements. I can remember myself as French finance minister undergoing difficult negotiations and having to give up some of what I wanted in order to obtain agreement. This represented a real change from the Snake and from the early days of the EMS, when realignments were still effectively unilateral affairs. The advantage to the system is that the parity grid gains additional credibility from the multilateral commitment of all participants.

As a result of the EMS, exchange rate variability among European currencies has fallen significantly. The variability of the Deutschmark vis-à-vis the currencies participating in the exchange rate mechanism has fallen from an average of near one percent per month before the EMS to below half a percent during the recent years, only to rise back so far this year to nearly one percent per month on average as a result of the turmoil in September. The number of realignments has fallen from seven during the first period of the EMS, to four during the middle period, then to only one until September of this year.

One major consequence of this monetary stability produced by the EMS has been to allow the move to the full liberalisation of capital movements which I initiated in May 86 in the framework of the large internal market. Free capital movements are vital to the creation of a single financial area in the Community.

The limits of the EMS.

However, capital liberalisation has also exposed the limits to the EMS. It brought to the fore the well known incompatible triangle: independent monetary policies, free capital movements and fixed exchange rates. All three cannot coexist as Tommaso Padoa-Schioppa reminded us.

This of course raises the question of fixed versus flexible exchange rates once more. One school of thought emerged during the negotiations for the Basle/Nyborg mini-package of 1987. It suggested that, since the institutional step necessary for monetary union could be insurmountable, increased exchange rate flexibility should be sought. In the end the Basle/Nyborg accord opted for increased stability taking the system to the limits of what was possible within the institutional constraints of the Single European Act.

The story of the EMS is not at its end. The emergence of full capital liberalization and the deepening of economic integration has left us with two basic problems.

* First, how to maintain and go beyond the limited stability provided by the EMS within the political and institutional limits of the Single Act, or to pose this in another way, how to react to the success of some currencies in progressively matching the performance of the anchor currency.
* Second, how to manage the financial markets in the context of an increasingly integrated world. The instant availability of information, the low cost of transactions, the almost unlimited supply of funds and the herd instinct of speculators pose a serious problem in the context of the EMS.

Part 3: The project of Economic and Monetary Union in the context of European Union.

In order to reply to these problems of the present EMS it has been necessary to make a qualitative leap to Economic and Monetary Union. It represents in a certain sense the jump from the coordination of the EMS to a process of progressive integration.

Let us first assess in terms of our previous analysis Economic and Monetary Union as it is contained within the Maastricht treaty. Like the Werner Plan, it is founded on both economic and monetary concerns in the context of European integration. Its principles, in contrast to those of the EMS, are of a strict parallelism between the monetary and the economic sides.

How does the Economic and Monetary Union of Maastricht address our basic problems related to the EMS?

* On the internal side, the Maastricht treaty lays down a strong institutional framework placing monetary and economic cooperation in the perspective of European Union, thereby opening a broader political context. Under the authority of the European Council it provides broad guidelines for economic policies under which the procedure of mutual surveillance can be exercised. It establishes precise rules incorporating both subsidiarity and the democratic accountability necessary for the establishment of an independent monetary institution. The new treaty can be seen as another step in the building of Europe following the large internal market of 92, which included the liberalization of capital movements, and the Single European Act, which provided its institutional base.
* As far as the external challenge is concerned, EMU will create a single, strong currency in the Community. While this does not touch directly on the international monetary system, it will constitute a building block at the European level that will facilitate the deepening of international monetary cooperation. The voice of the Community will be better heard in the context of G7. Europe's integrated capital market will become more attractive. The ecu will take its place as the third pillar of the international monetary system together with the dollar and the yen.

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