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European Monetary Union

The discussion on the subject of a monetary union within the European Economic Community has been very intense during the past. But which are the problems yet to be solved? And can the monetary union pave the way towards an economic and political union?

No First Step to Political Union

by Dr Max Iklé, Zurich

Realisation of a monetary union within the European Economic Community is without doubt an aim worth pursuing, provided it is not intended as a challenge to the dollar but as a measure to strengthen the Western monetary system. Monetary union seems however such a distant aim that it is thought to be attainable only by a series of successive steps. In the following an attempt is made to throw some light on the technical problems that will arise as the various steps are taken.

Monetary Aid: No Innovation

The short-term monetary aid measures which have been decided on as a first step are nothing new. Cooperation in monetary matters on a world-wide

scale has been in existence since 1961. If a country is in need of support from third countries, such aid is useful only if the currency placed at its disposal is readily acceptable all over the world. The only currency that meets this requirement today, and will continue to meet it for some time to come, is the dollar. European currencies because of their limited use are not suitable for such purposes. If European Central Banks are not in a position to place dollars at the disposal of a partner-country—such a case occurred only recently—the only recourse open to that country is to fall back on the swap-arrangements with the United States. Crises of the scale as the pound sterling and the French franc have recently experienced can

hardly be overcome by European efforts alone. In such cases monetary aid on a world-wide scale is essential, and that means US cooperation.

The same problems arise where medium-term monetary aid is required. Moreover, no Central Bank should for reasons of liquidity enter into long-term commitments. For such aid one would have to enlist the support of states; but this is obviously not the intention.

European Monetary Fund

For these reasons the idea of a European Monetary Fund has been well received in many circles because it is seen as a spectacular step in the direction of a future European Central

Bank. Such a fund would obviously have the task of granting foreign exchange credits and of intervening on foreign exchange markets with a view to reducing currency margins within the Community to a minimum. The scope such a fund would possess for granting credits would however in all probability be narrower than that of the participating Central Banks concerned. More important still, the fund would hardly be in a position to grant dollar credits. In comparison with the extent of co-operation which has hitherto existed between Central Banks and with the credit facilities available from the International Monetary Fund, the proposed European Monetary Fund's potential would be rather modest.

The question therefore remains whether the fund would be able, through operations on the foreign exchange markets, to keep fluctuations of currencies within EEC in narrower limits. The way Central Banks operate on the foreign exchange markets is as follows: when a balance of payments shows a surplus, they buy dollars at the upper intervention point and they sell dollars in the case of a balance-of-payments deficit. That foreign exchange operations are carried out with dollars is due to the fact that the dollar is today still the most widely-held currency and as such generally accepted as international means of payment. A European Monetary Fund, however, would have no dollars at least in its initial stage. It would therefore be obliged to intervene with European currencies. Now the sale of a European currency in a national market depends on that market's willingness to take up the currency used for the intervention. Should the fund however feel bound to buy dollars on a national market in order to prevent an undue rise in the rate of the national currency con-

cerned, it would come into conflict with that country's Central Bank which is intervening in the foreign exchange market with dollars from a different point of view. It is here that the greatest difficulty becomes apparent: it is hardly conceivable that two different monetary authorities pursuing different objectives should intervene in one and the same market.

Narrowing the Currency Margins

All plans that have so far become known for a step-by-step introduction of a European Monetary Fund provide for a narrowing of currency margins within the Common Market or even their complete disappearance, while the European bloc as a whole is to retain its flexibility in regard to the dollar. The layman can scarcely imagine how difficult it would be to achieve this objective. The customary interventions by the Central Banks logically followed from market developments. They led to dollar purchases in countries whose balance of payments showed a surplus and the sale of dollars in the case of deficits. In future, a third factor would have to be taken into consideration, i.e. the narrowing of currency margins within the Community. Now where would be the correct dollar rate for five or more countries of which some have a surplus while others are in deficit? Would the result of such a policy not be that the Central Banks would be obliged either to buy dollars at entirely arbitrary rates although the country is in deficit or sell dollars in spite of balance-of-payments surplus?

This difficulty has apparently been recognised already. For a plan has meanwhile emerged which provides that only one country should nurse the rate against the dollar, whereas the others, like satellites, should follow in the wake of the lead-

ing currency by intervening with European currencies. If such a plan were adopted, it would soon become apparent that the only currency that can be used for purposes of intervention is the currency of the country which determines the rate for the dollar as dollars would only be available via the currency of that country. Upon that country would thus fall the leading role in the field of monetary policy — a role which would be by no means enviable. For its Central Bank would see itself obliged to exchange its own currency for the currencies of the deficit countries whenever these are in balance-of-payments difficulties. The deficit-countries for their part would have no alternative but to buy the dollars they require for the defence of their currency from the banks of the leading country. In these circumstances it might easily happen to the leading Central Bank that it accumulates in its reserves the weaker European currencies whereas it requires dollars for purposes of intervention.

No currency specialist has so far succeeded in suggesting a convincing intervention technique which would solve this problem. It is easy to understand therefore the scepticism of some of the governors of Central Banks in Common Market countries who describe the abolition of currency margins within the Community as a risky experiment. Economic considerations as well as monetary arguments of a technical nature exist that are against realisation of this stage.

Synthetic Currency

The monetary experts in Brussels never tire of putting forward new schemes. Latterly there has been talk for instance of realising a plan which was first put up for discussion by Professor Mundell of Chicago. According to this plan, the Euro-

pean Central Banks should issue a new currency — the ECU which would at all times be convertible into dollars. This new currency is in the first instance to replace the Dollar Traveller Cheque. The new synthetic currency would have a fixed parity with gold and serve as travellers' money throughout Europe. In advocating this scheme, the EEC specialists in money matters apparently overlook the fact that to give the new currency a parity is not enough; it must also have a rate of exchange. The rate of exchange for any currency is arrived at in the foreign exchange market as a result of the interplay of supply and demand, the process being smoothed out by interventions on the part of Central Banks. In the case of a synthetic currency these determining factors are missing. Such a currency would therefore have to be given an

artificial rate, and the dollar automatically springs to mind. If this is so, the European Central Banks would be expected to put a strange currency into circulation and take it back at all times at the dollar rate. The European Central Banks would thus be compelled to enter into unlimited forward commitments, both as to time and quantity — an undertaking they can hardly be expected to give. This example illustrates that it is not so easy to create a new currency out of nothing.

The Right Way

These few considerations should be sufficient to show that the suggested steps that are to lead to a European Currency can hardly be taken. A European currency can become a reality only when the countries of the Community have a

common economic, monetary, credit and incomes policy directed by a supra-national authority, while a central note-issuing institute watches over the common currency in the interests of the Community as a whole. But this is tantamount to the individual countries' giving up their autonomy in the most important fields of economic and monetary policy, and this is conceivable only within the framework of political union. A monetary union therefore does not open up the road to political union, but is its logical consequence. Only a united Europe will be able to create a monetary union. Intermediate stages on this way are impracticable, unless it be the harmonisation of economic policies; such an alignment would in itself appear desirable for it would avoid disturbances in the Community such as it exists today.

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