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## Floating exchange rates are no panacea

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Britain's entry. By adding Britain to our Community, the currency union will for the first time gain the appropriate size. Only by taking in the UK, the Community will become a currency partner able to make a worthwhile contribution to reforming the currency system of the world. Britain's importance for the future economic and currency union derives, on the one hand, from the British economic potential, on the other hand, from the financial know-how, the immense experiences, and the influence of the City.

It is clear that there will still have to be discussions about the conditions for the integration of the sterling currency with the overall system of the EEC. But it is not absolutely necessary to delay, for this reason, the completion of the economic and currency union's first stage. As to the currency union, the British authorities have never made any

adverse comment. Whenever I had talks on this subject with the highest British personalities, I was always told that they are willing to make their own contribution. When speaking to British partners, I found that they were much less sceptical about the economic and currency union than on numerous occasions many continental Europeans.

*To conclude, let us assume that future developments will take the most unfavourable course: that there will be no economic and currency union, for whatever reason. What would be the effects of this failure for Europe?*

Without doubt, this would gravely weaken Europe, both economically and politically. In the first instance, a number of achievements, which we have already reached, would be threatened. For example, I could

not see how the common market for farm produce could then survive. If we give up work for unifying our currencies, the inevitable effect will be the revival of mutual trade barriers, of currency controls, of the trends towards autarky, which we have witnessed during the thirties. Trade between member countries would be badly affected. It might be perhaps possible to keep in being a free trade zone, but our economic importance would fade away.

Politically, too, a failure to build an economic and currency union would have highly adverse effects, for in the last analysis, the development which has started aims at political unification of Europe. It is true that we need not achieve a European confederation or federation tomorrow. But to arrive at this ultimate goal, we must first take the step of creating an economic and currency union.

## Floating Exchange Rates Are No Panacea

Six Questions to Professor Raymond Barre, Vice-President of the EEC, Brussels

*Are floating exchange rates a long-term danger for the projected economic and currency union?*

There are various answers to this question, depending on whether all the national currencies within the Community are intended to be floating, independently of each other, or whether they will be floating together but on the basis of fixed exchange rates within the Community.

In the first case, the fluctuations would be in complete contravention to all that is needed

for building an economic and currency union, and they could even prevent a common market from operating smoothly. In order to enable the policies of our governments, the strategy of our business entities, and the behaviour of our nations to treat the existence of the European Community as a decisive factor, it is the principal duty of the Community to provide them with the fundamental instrument of unambiguity of all their transactions, which is a common yardstick of value.

Moreover, if individual currencies within the Community were allowed to fluctuate separately and independently, the Community would be exposed to the risks of "rotating" speculation, feeding upon the immense reservoir of available international liquidity. This would create the danger of our currencies' exchange rates fluctuating in virtual independence from the basic facts which make up the situation of our national economies, in a similar way as stock exchanges are quoting certain securities much higher or lower,

in the various markets, than the actual situation of the companies concerned would justify.

And finally, the uncertainty about possible future fluctuations of our currencies' exchange rates would cause the member countries of the Community to use, for their transactions, more and more foreign currencies, whose stability seems assured—notably the US dollar—, instead of their own ones. Since the time when the German DM and the Dutch guilder have been allowed to float freely, this trend has already become visible.

*And is it not a fact that we could hardly hope for further progress on the way towards co-ordination of economic policies within the Community, if freely floating exchange rates tempted each and every member state to operate independently?*

This is indeed the case. And that is the reason why the Council of Ministers of the Community has refused to create flexible arrangements for currency relations within the Community, e.g. floating exchange rates, wider bands within which floating would be permitted, sliding parities, etc.—without, however, excluding changes in exchange rates in cases in which they are necessary.

*What are we to think of all the Community currencies floating together, in relation to the outside world?*

The international currency system has suffered grave distortion both through the permanent deficit in the balance of payments of the United States, and through the huge growth of liquidity and the United States' privilege to finance its deficits through unconditional and unlimited accumulation of dollar balances with the central banks of other countries. This, of course, creates the temptation to defend these countries against the dangers of imported inflation by making the exchange rates of their own currencies flexible. Such a solution appears the more attractive because it would accelerate progress towards our economic and currency union: in order to make the exchange rates of our currencies float together, we would have to set up common machinery for intervention on currency markets. This again would cause solidarity in currency policies and inevitably also solidarity in other fields, especially in reducing the cyclical and structural differences between the national economies of member states.

#### **The Effects of Floating Currency Rates**

There are even people who believe that joint fluctuations of the prices of EEC currencies might deter speculators, because there would be only a limited number of currencies (or groups of currencies which are closely linked) available in cur-

rency markets, which represent large economic regions. However, such an effect appears less probable than it might appear at first sight, because the American deficit is, to a large extent, caused by expenditure which is not connected with trade, and which will therefore scarcely be affected by changes in exchange rates. Therefore, constant pressure might lead to a steady rise in the value of our Community currencies, independently of the development of trade relations between, on the one hand, our own countries, and, on the other hand, the United States and the remaining countries outside the Community. If the European countries wished to restrict such a rise in the value of their own currencies, in order to avoid a decline of their exports, they would have to intervene in the currency market through buying dollars.

*And how do you assess the effect of widening the limits within which our currencies may fluctuate against those of third-party countries?*

In a situation in international currency markets for which a chronic deficit of the United States' balance of payments and large volumes of capital able to flow from one country to another are characteristic, it appears better to stick to fixed exchange rates as major part of the international economic and currency system, and to protect them by combining measures for

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preventing or limiting the effects of capital inflow upon internal liquidity with a certain extension of "band widths", against third-party countries. But such an extension would have to remain strictly limited, in order to avoid adverse effects upon the trade in goods, and in order to avoid giving an incentive to speculators, instead of putting the brake on them.

### Structural Causes of Inflation

*Do you believe that the Federal Republic of Germany must return to its old exchange rate, or would the Commission show understanding for a revaluation of the DM?*

The most important thing is that the DM returns to a fixed parity. It is the Federal Govern-

ment which has to decide on this exchange rate, taking into account the situation prevailing at that moment, its own economic aims, after the usual consultations within the Community. The Commission, for its own part, will always endeavour to help the Federal Government in accordance with the rules and the spirit of the Community.

*Will the Federal Republic be obliged, in future, to revise its ideas of stability, which are very strict, compared with those of its partners in the EEC?*

As inflation is, without doubt, the worst danger for our national economies, it always has been and still is our wish that all the countries of the Community value stability as highly as the Federal Republic of Germa-

ny. However, the conditions for ensuring stability are different in different member states. In some of these countries, there are structural causes which induce inflation. Any policy of the Community for growth with stability must therefore not only use suitable overall policy measures but also national and joint measures for improving the economic structure.

It must also not be forgotten that, in all countries, inflation is at present kept going by an income development which is incompatible with the maintenance of a basic economic equilibrium. Restoration of stability, therefore, depends mainly on all the partners in a given economy showing moderation in their claims and a sense of responsibility.

## Floating May Strengthen the Currency Union

by Dr Hans-Eckart Scharrer and Sabine Harmsen, Hamburg\*

Only three months had passed between February 9, 1971, the day when the European Economic and Currency Union was started, and May 9, 1971, when the Council of Ministers of the EEC agreed to the temporary floating of exchange rates for the currencies of some member countries, in order to overcome the international currency crisis. On May 5, the foreign currency markets in the Federal Republic, in the Benelux countries, in Switzerland and Austria, had been closed. After

that, the machinery of consultation, as provided for in the resolution of February 9, was used in the correct way, which means that the projected economic and currency union has survived its first difficult trials, at least from the procedural point of view. However, it must be doubted whether the material result of these consultations was equally praiseworthy.

### A Difficult Compromise Between the Six

This decision authorises the Federal Republic of Germany and the Netherlands to enlarge,

for a limited time only, the width of the margins within which their currencies may float, in view of the exaggerated inflow of capital from abroad. But to this authorisation is at the same time opposed the clear statement that "under normal conditions a system of floating exchange rates within the Community would be incompatible with its successful operation". It is especially this concluding sentence which makes it clear that the resolution, described as a joint decision, was only a compromise achieved through laborious negotiations, intended to prevent a breakup of the Community.

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