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## Floating may strengthen the currency union

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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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It is true that the EEC managed to preserve the formal principle of fixed internal exchange rates, since waiving the duty of intervention for the central banks of two member countries was agreed to while, simultaneously, the old parities are being maintained, and the floating period was considered by all member countries to be only a passing phase. It is a fact, however, that the six member countries of the EEC were unable to agree on a common concept of a currency policy for overcoming the currency crisis. As the member countries have remained, as before, autonomous in their currency policies, it was not possible, in the last analysis, to prevent the Federal Republic from taking those measures which it thought fit for achieving stabilisation. In the words of M. Raymond Barre, the Vice-President of the EEC Commission, "concerting our measures (has) not led to common action but to taking cognizance, within the framework of the Community, of certain unilateral measures, and to restricting their effects upon the Community"<sup>1</sup>.

#### Alternatives Presented at Brussels

For enabling the Community to achieve a common solution, a number of draft proposals had been placed on the table of the Commission, e.g.:

- ☐ simultaneous revaluation of all the EEC currencies, in order to discourage speculation;
- ☐ an agreed but limited—both in time and in size—release of all the currencies of the EEC from fixed parity against the dollar, but coupled with the maintenance or reduction of

present margins of fluctuation between them;

- ☐ a minor extension of these margins between individual EEC currencies;
- ☐ joint measures of currency control, in order to keep out speculative capital inflows, whilst maintaining existing exchange rates.

However differences of opinion emerged, partly based on differing economic doctrines, partly on technical difficulties, and partly on the interests of individual countries being opposed to each other, which prevented the achievement of a common solution.<sup>2</sup>

#### German-French Antagonism

Ultimately, agreement was hindered because of the antagonistic views of Germany and France. At Brussels, two theories clashed as to how the currency crisis could be overcome: the liberal views of the Federal Republic, and France's *dirigisme*. The *dirigiste* method of introducing temporary currency controls for warding off the flood of dollars, in the French view, and in that of the Commission, would have enabled the Six to maintain their solidarity and to develop a united stand as against the dollar. According to Bonn's liberal opinion, a temporary release of exchange rates from their fixed levels was a more suitable instrument for dealing with an equally temporary disequilibrium between balances of payments, caused by violent but short-term international movements of capital. True, it was admitted that this solution was far from being ideal, especially in view of its effects upon the agricultural system of the EEC and

on the intended narrowing of floating margins between individual EEC currencies. The decisive argument of the critics who object to the Federal Republic's attitude at Brussels was, however, the belief of Germany's partners in the EEC that the German delegation had come to Brussels absolutely determined in advance to insist that its preconceived opinion must be accepted under any circumstances—though it cannot be denied that other delegations, in the past, had also frequently sinned against the community spirit.

#### Fragile Agricultural Market of the EEC

To ward off the harmful effects of free DM and Dutch guild exchange rates upon the Common Agricultural Market, the Ministers of Agriculture of the EEC, it is true, succeeded on May 11 and 12, 1971, in agreeing on a system of equalisation levies in favour of the Federal Republic and the Netherlands, and thus in keeping in being the fiction of a common market and of a common accounting unit. But the immediate effect of these equalisation measures for farming produce crossing frontiers is the splitting of the agricultural market into four separate parts: there are now a German, a Dutch, a French market,<sup>3</sup> and a "residual" common agricultural market consisting of Italy, Belgium and Luxembourg. In other words: only three of the six member states are still subject to the "normal" rules of this important part of the Common Market, and it is much to be doubted whether this provisional arrangement could survive a

<sup>1</sup> See the statement of M. Raymond Barre during the meeting of the European Parliament on May 18, 1971, in: Official Bulletin of the European Communities; Negotiations, No. 138, May, 1971, p. 35.

<sup>2</sup> See the Statement of M. Raymond Barre in the European Parliament, I. c., p. 35.

<sup>3</sup> After the devaluation of the French Franc in 1969, certain measures for bringing France back into the common agricultural market had to be taken, and these were only to be completed during the current year.

longer floating period of some of the members' currencies, for the agricultural market is so constructed that its machinery is highly sensitive to changes. Its basis are fixed rates of exchange.

### Does Calculated Floating Provide a Solution?

It is unpredictable what will be the effects of the decision to float the exchange rates of the DM and Dutch guilder upon further economic and monetary integration of the EEC. It was intended to take a first practical step towards establishing a European economic and currency union on June 15, 1971, by experimentally reducing the permissible width of parity margins between EEC currencies from the previous limit of 1.5 p.c. to 1.2 p.c. But through the decision of May 9, 1971, any further progress towards closer monetary cooperation has been blocked at least as long as the DM and the Dutch guilder continue to float<sup>4</sup>. On the other hand, it may be considered as a positive component of this development that discussions on the future part which the EEC will have to play in the international system of

currencies have grown much more realistic recently. In this context, it is of special interest that it now appears possible to introduce limited flexibility of EEC currency rates against the dollar.

The new formula is known as "calculated floating", which means that EEC currencies should be allowed to fluctuate, on both sides of dollar parity, up to a maximum margin of 2 to 3 p.c., whilst the rules of the IMF have hitherto fixed this maximum at 1 p.c. only. This amendment of the EEC's currency system is to be integrated with a reform of the floating margins of the international currency system. An additional aspect of this emerging solution

<sup>4</sup> During the European Parliament's meeting of May 18, the Dutch deputy, Mhr. Oele, characterised the present situation as follows: "The present situation means, in effect, that the economic and currency union has been put into cold storage, that the common agricultural market finds itself in the hospital's observation ward and, if need be, may be kept on its legs by drug injections, and that the Community as a whole, which until lately had shown such promising growth, has become a field for experiments with a great number of interesting and far-reaching ideas, which have been very nicely prepared but which are either not applied at all or, if carried out, are being used in an extremely clumsy way." From the Official Bulletin of the European Community, I. c., p. 38.

would be a gradual reduction of floating margins between individual EEC currencies, after the DM and the Dutch guilder have been formally revalued. This new action programme for a currency policy could probably become effective, at the earliest, only in 1972. It would make the currencies of the Six grow together progressively and have the effect that the EEC currencies might float, as a united bloc, within a margin of 4 to 6 p.c. against the dollar. If such a programme could be actually carried out, it would be found that freeing the DM exchange rate to find its own level, instead of being branded as harmful for the Community, as was the case originally, might now be welcomed as having helped, on the contrary, to speed the Community greatly along its way to a European currency union. But the question remains, of course, open whether the political determination of EEC members to build a currency union has suddenly become overpowering enough for these states to find the strength for manoeuvring themselves out pragmatically from the impasse of dogmatic national priorities to which they have fled.



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