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EEC – Urgency of Monetary Integration

by Professor Andreas Predöhl, Münster *

For many years, the guardians of the world's currency system have tried to cure the symptoms of its illness. They were not even altogether unsuccessful in their attempts to maintain the system of Bretton Woods. But its shortcomings are still conspicuous. One crisis after another occurs, and the fear lest the system which is tied to the US dollar disintegrate has never faded.

The Bretton Woods Agreement, from its very inception, was full of fundamental flaws. It laid down that rates of exchange should remain both stable and free. But such rates of exchange, both stable and free, are possible under one condition only: that they are firmly tied to gold, which means that all governments that have adopted this system regulate their measures for either increasing or cutting down the volume of credits with determination in such a way that exchange rates cannot vary, or that their credit policies are coordinated to serve the common aim to maintain strict parity of their individual currencies' purchasing power. But, since the big world slump of 1931, this has become impossible. There is no single country in the world able to abdicate its authority in the field of national business policy, which, from 1931 onwards, has assumed the place formerly claimed by the automatism of the trade cycle. On the other hand, it is impossible to coordinate the credit policies of all countries. Measures to increase the volume of international liquidity have been taken repeatedly, it is true, to overcome discrepancies in the international balance of payments, but such measures are unable to avoid them altogether.

European Regionalism

The siren songs of dogmatic liberals, who try to persuade us of the alleged simplicity of a solution by making rates of exchange float freely, have fortunately not managed to convince any of the makers of currency policy. Neither does widening the margins, within which currencies may

fluctuate, overcome our difficulties, since they operate in the same direction as does increased international liquidity. Within the framework of European integration, it would be particularly inept to loosen the ties which keep parities on a fixed course.

There is only one safe way to get out of the maze of world currency problems – that of European regionalism which the countries of the European Economic Communities have already chosen for their trade policies for guiding them towards European integration. This choice also stems from the world economic slump of 1931. Active cyclical policies, which then began to replace the spontaneous cyclical movements of the economy, brought the impact of national frontiers to bear on the automatic mechanism of world trade. Tracing this influence of trade nationalism upon the area encompassed by world trade, we find that the industrial forces rooted in the two huge national markets of the US and the USSR were but little affected by it. Foreign trade of these two countries plays only a negligible part, compared with their immense turnover in home markets. In Europe, however, the disintegrating influence of national frontiers cuts right through the middle of the most closely intertwined and sensitive exchange relationships, which constitute the network of a single field of industrial activities. That is why an integrated system of relations must be rebuilt in the field where European economic energies operate, whereas the other centres of world trade never lost their integration. In the same way as payments are being balanced internally within these centres, the international concentration of economic potentials in Europe must seek its own balance.

* Shortened version of his article, "Ist endlich eine Lösung des Währungsproblems in Sicht?" (Solution of Currency Problems in the Offing, At Last?), in: Volkswirtschaftliche Korrespondenz der Adolf-Weber-Stiftung (Economic Newsletter of the Adolf Weber Foundation), No. 10, 1970.

This does not mean that currency policy should build a wall of self-isolation round the EEC. On the contrary, the more perfect the internal balancing will be, the better will be the safeguards for a big volume of trade with the extra-European areas. Trade policy and currency policy have always been in step with each other. During the century of liberalism, the gold currency was the equivalent of a more or less universal free trade. After the system of liberal world trade had been destroyed through the world slump, both trade and currency policies of individual states became autonomous – orderly world trading connections had disintegrated. European regional integration will thus become one of the first steps to be taken by trade and currency policies on the way back towards a global world economy. European integration, therefore, is not only a task for Europeans but also a stepping-stone leading to a new world economy.

Astonishingly enough, currency experts show very little insight into the interdependence of these facts, both in their theory and in their practice. Within the EEC, comparatively little regard has been paid to the currency problems which are tied up with European integration. Had there not been the Treaties of Rome which contain such reassuring clauses in this respect, there might have been sufficient reason for being afraid that those who had taken the initiative for forming the EEC had at the same time been ignorant of the fact that every single success of trade integration – whose successive stages had been very precisely worked out in advance – will remain at risk as long as the problems of currency integration remain unsolved. Only very recently, increasingly stronger advocacy of rapidly overcoming the obstacles that stand in the way of European currency integration has become audible. It seems virtually certain that it was only the rising difficulties experienced by the management of agricultural markets, which are based on the “green dollar”, from the time when the DM was revalued and the French franc was devalued, which have jolted responsible EEC leaders into appreciating the overriding urgency of monetary integration.

United Currency

It has taken until now that the interdependence of intra-European currency difficulties with those of the world currency system is seen – but unfortunately still mostly from the more obvious point of view that it is necessary to divorce the European currencies from the dollar – which is insufficient and one-sided. The divorce from the dollar, it must be realised, is one of the two poles of the problem, the other one of which is the creation of a unified European currency, whose importance

must be equal to that of the dollar. As soon as the European central banks start to operate a rising volume of exchanges with the US, bilateral solutions of problems arising between Europe and the United States would assume much greater and mounting importance. Yet, notwithstanding this, big long-term imbalances may still arise, and they could only be dismantled by revaluation or devaluation of the currencies affected. In such cases, graduated flexibility of exchange rates, also known as “crawling pegs”, might play a major part.

It is not at all surprising that no overall solution of the currency crisis has yet been worked out, seeing that all the currency specialists are tied down by difficult questions of detail, of which there are indeed many and grave ones. Under the influence of Professor Milton Friedman, even the extremist liberal position, which recommends completely free floating of all currencies, has regained some importance. That his proposal, which would mean the winding-up of the International Monetary Fund, failed to find much favour was almost the only response to be expected, because of the currency politicians' traditionalist attitude. They never got further, in their deliberations, than proposing temporary solutions for the whole complex of problems, such as widening the margins of fluctuation, a temporary floating, or the crawling peg. It virtually looks as though it is impossible to find the way to an overall solution via regional arrangements, and divorcing European currencies from the dollar seems to be the step beyond which currency experts' imagination cannot rise.

Difficult Overall Solution

But there may perhaps be some hope that forces that have been operative inside the EEC for some time will induce progress. Even though the interdependence between regional solutions and the world currency problems are rarely seen with complete clarity, overcoming Europe's currency difficulties might lay the foundation for also dragging the world currency system out of its slough. The determined fashion in which especially the French plead for rigidly fixed rates of exchange within the EEC indicates that, to say the least, the focal parts of the problems are correctly visualised. If we add that this kind of solution is completely compatible with worldwide flexibility of currency rates, floating of currencies worldwide might become more acceptable, especially as there is great likelihood that this is unavoidable, to overcome the problem of the dollar.

Separating intra-European rates of exchanges from those in the world currency markets will, of course, not be the complete and final answer

to the question of one single European currency. There is a whole and highly diversified range of possibilities, from one single European currency down to loose and flexible cooperation. The one and indispensable need is for unifying national cyclical policies to such an extent that fundamental and permanent price disparities will be excluded. The EEC Treaty does not contain any clauses which regulate these points. Admittedly, we find there numerous hints and recommendations admonishing member countries to work for equilibrium in their respective balances of payments, through their economic policies, but no binding obligations or prescriptions for giving up national autonomy in currency questions. Even the European Currency Agreement (ECA) or the European Payments Union (EPU), which have made European currencies convertible, do not refer to the causes of disparities between currencies.

There is, for example, the contentious question whether economic integration should begin, or end, with unification of currencies. It may be true that, for material reasons, unification should be the crowning end of the process of integration. However, should it be possible to arrive at it earlier, this would be a powerful motor of full integration. And to wait for the solution of currency problems until the EEC is fully consolidated is unjustified perfectionism. There will always be differences of opinions and interests if and when waiting for perfect harmonisation holds up intra-European trade liberalisation and the creation of a joint business policy, which would also prevent the adoption of a joint currency policy.

Federated Central Banks

There is also the moot question whether currency unification has to be preceded by political integration. Taking the United States or the Soviet Union as model cases, it might appear that it is necessary to integrate Europe as well through the instrument of one single and unified currency. Viewed from a purely economic angle, this would be, without doubt, the optimal method. But it must not be ignored that a currency union of such perfection is conceivable only in a highly advanced state of economic integration, which means that national member states would have to shed many of their sovereign rights. Yet plans of this kind which much transcend the customs union, in itself already a brittle construction, must be recognised for what they are: pure illusionism, at least for the time being. It is even questionable whether they are worth striving for. They are ill suited to serving political federalism which, for historical reasons, is the only acceptable political structure for Europe. If acceptable solutions of an intermediary character can be

found, it is even unnecessary to advance so fast and so far.

In other words, the integration of European currencies need go only so far and no farther than that supra-national leadership and management are assured. For this purpose, contractual relations which set up a kind of federal reserve system would be sufficient, because national central banks would survive but would work under a system of unified policy making. An international council of central banks could safeguard all national interests. As much as it is desirable to oppose to the dollar a European unit of accounting, national currencies need not disappear. A clearing union of the type suggested by Keynes might be useful, though it would have to be invested with much wider powers than those of the former European Payments Union. To ensure regional cooperation inside the EEC weaker forms of cooperation in the currency field would be sufficient.

All-European Integration

Regional solutions need not be restricted to the EEC area, because—speaking regionally—the EEC itself is only a partial form of integration, as long as not all the member states of EFTA have joined it. The EPU, which has been mentioned several times already, could become the basis of the new structure, since all the Marshall Plan countries were its members. ECA, which is the successor organisation of EPU, might be widened to form a European currency union, and this might lead to the establishment of a fully-fledged (both geographically and functionally) counterpart of the US Federal Reserve Board. There exists already a body that would be suited to become the new union's executive organ — the Bank for International Settlements (BIS) at Basle. The adoption of such a scheme would be useful for fostering further development of the EEC, because it could promote overall European integration.

The theory of economic development tends to show how rational economic trends may overcome opposing political forces. The findings of this theory permit us to work out a favourable forecast for the future of European integration, and in particular also for the future of specifically monetary integration. The political forces militating against such developments are far from weak. It is therefore advisable not to tie up political with economic integration. Though political integration, it is true, remains our supreme and perhaps ultimate aim, to work for it openly would not foster economic integration at the present juncture. It is much more likely that a completed economic integration may irradiate such power that political integration must come in its aftermath.