Issing, O.

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Towards an Economic and Monetary Union

by Professor O. Issing, Nürnberg *

One of the most important results of the Paris Summit of the nine EEC-members was the decision taken to establish a European Monetary Union until April 1, 1973. Will the Economic Union be now approached more rapidly than in the past?

After the end of the transitional period on January 1, 1970, the European Economic Community has entered upon its final development stage. The Customs Union had been completed on July 1, 1968. Internal customs duties and physical trade restrictions had been abolished, whilst common external tariffs had been introduced as a joint protective screen. At the same time, free intra-Union movement of labour had become operative, and thus an important step towards a Common Market had been done. That the EEC has not yet completely achieved this major aim of integration, is caused by the great number of surviving controls of capital transfers.

End of the Transitional Period

These obstacles in the way of free capital movements are a clear sign that in other fields the EEC has not been so successful, by a wide margin, as in building a Customs Union. Although prolonged and arduous efforts have been undertaken towards coordinated economic and monetary policies, no major progress could be made. Thus, to quote the intermediary report of the Werner Commission (on p. 6) it may be stated that "all the efforts so far have achieved partial successes but, in fact, have not led to genuine coordination or harmonisation of economic policies within the Community, although this would have been compatible with the spirit of the Rome Treaty, and applying the fundamental clauses of that Treaty, notably those about economic and monetary policies could have been realised".

From the time that the Customs Union has been in force, such coordination of economic and monetary policies of the individual member states has become ever more urgent than before. Dismantling of obstacles to intra-Community trade causes trade to flow rapidly down the slope of any differential produced by different developments in individual member states and thus to transfer every economic trouble from one to all other Community countries.

As individual economies of member states are strongly interdependent through the absence of intra-area obstacles, it becomes virtually impossible for them to pursue "autonomous" economic and monetary policies. Any attempt of any given member state to run counter to this by insisting upon making its own economic and monetary policies will therefore produce severe disturbances of intra-area equilibrium. An imbalance of mutual payments is the most sensitive indicator of incompatibility between diverging economic and monetary aims and measures. During the economic crises which have followed one another from 1968 onwards, the restrictions of convertibility and shifts in rates of exchange signalled that this adverse development approached its summit.

The Summit Conference at the Hague

Whereas the Treaty of Rome describes the steps which were gradually to lead to a customs union in detail and with precision, it contains only few and somewhat vague prescriptions about coordinating economic and monetary policies. In Article 103, Paragraph 1, the first sentence thus states that "... member states see in their business cycle policies a matter of common interest". In Article 104, member states "pledge themselves" to adopt the aims of the "Magical Triangle", and Article 105 tells them to "coordinate" their economic policies. Obviously, such rules, which are far from binding on the signatories, are insufficient to guarantee the required coordination. Forming a number of committees dealing with the coordination of economic and monetary policies did not help either.

After a phase of paralysis and resignation, the Summit Conference of heads of states and/or governments, which took place in The Hague on
December 1 and 2, 1969, made a new attempt at achieving progress. The conference's final communiqué describes the agreement achieved by the participants under Point 8 as follows: "They reaffirm their will to promote and accelerate the elaboration of the Economic Union which is needed for strengthening the Community. They hold that the process of integration will inevitably set up a community for stability and for growth. Pursuing this aim, they have agreed that the Council (of Ministers), following the Commission’s memorandum of February 12, 1969, and cooperating closely with the Commission, will elaborate, during 1970, a graduated plan for establishing a complete economic and monetary union. Cooperation in monetary questions should be based upon harmonisation of economic policies . . . "

In pursuance of this agreement, the Council of Ministers, on March 6, 1970, set up a working group presided over by the Prime Minister and Minister of Finance of Luxembourg, M. Pierre Werner, and charged it with the clarification of basic conditions and requirements for building an economic and monetary union by graduated steps.

**Characteristic Features of a Monetary Union**

In its details, what a monetary union ought to be is still very much a matter of debate and contention. However, it is generally accepted that any monetary union can exist only under certain inescapable conditions, as:

- Full convertibility of all currencies of the union's members, with no restrictions whatsoever, which means that this necessitates also complete freedom of capital transfers;
- Unchangeable, fixed rates of exchange without margins of fluctuation; parity fluctuations (between member countries) are thus out of the question.

It is a decisive condition, however, that these rules must be made *irrevocable*. Shifts of exchange rates and restricted convertibility will not be acceptable, even as "emergency measures", as soon as the final steps have been taken for forming a monetary union. Viewing the problem from this angle, the question whether a monetary union, once formed, also requires one single currency only, or not, goes far beyond a merely psychological expedient. Should there be, after a monetary union has been formed, only one currency in circulation all over its area, this would, without doubt, supply the required guarantee for its irrevocability. Only if the principle of irrevocability can be firmly entrenched and secured even though national currencies should survive, then the difference would be of a merely formal nature.

From these existential conditions for forming a monetary union there flow inevitably also institutional consequences for both economic and monetary policies. For example, member states will have to give up their national sovereignty over some decisive questions and to cede them to supranational institutions. In two fields, such derogation of national sovereignty is particularly incisive. One of them will, obviously, be monetary policy. It would be impossible to permit the central banks of individual member countries to continue regulating the volume of circulating money "autonomously". If there should be one single common currency this would only make it more obvious that setting-up a common central bank becomes indispensable. Because of the close interrelation between monetary and financial policies, forming a monetary union furthermore makes it imperative to reduce the autonomy of member countries severely, also in this field. This applies above all to budget policy, and here again mainly to decisions about budget surpluses or deficits.

This cursory glance at a monetary union's requirements is sufficient to show up the potentially explosive character of some political problems connected with them, once a monetary union exists. Problems of a kind as to how to regulate the position of a common central bank vis-à-vis other Community agencies and individual national governments; how the making of financial policy decisions can be delegated to Community agencies, and how such authority and decisions can be controlled democratically through a European Parliament which would have to be strongly "up-valued" — all these must necessarily make a strong impact upon the political structure of members states.

**The EEC's Graduated Plan**

The Werner Working Group presented its final report on the gradual inception of an economic and monetary union on October 8, 1970. Because this report was very outspoken on the political effects of the steps proposed, it quickly became a bone of severe contention. Especially the following passage of the Werner Report underlines the close connection between economic and monetary as well as political integration: "This leads to the conclusion that setting up an economic and monetary union presupposes institutional reforms including the creation of new, or reform of existing, Community agencies, to whom authority must be delegated which hitherto had been the preserve of national institutions. This delegation of authority is a process of fundamental political significance, which can only be based on progressive intensification of political cooperation. An economic and monetary union becomes thus
a ferment fostering the creation of a political union, without which the economic and monetary union would not be able to survive." ¹

The Communities' Commission tried to anticipate the objections expected from the French, by drawing up a number of its own "statements and proposals". What the Commission had said in these statements and proposals was then criticised, especially by the Germans, who alleged that the careful balance which had been represented in the Werner Committee as between economic and monetary policies had been one-sidedly destroyed by making "advance concessions" in favour of unified monetary policies.²

Tedious negotiations began, and they produced a compromise resolution of the Council of March 22, 1971, on the step-by-step formation of an economic and monetary union within the Community. This presents a Three-Stage-Plan which, over the ten years from January 1, 1971, should be followed in creating the Economic and Monetary Union. During its final stage, the conditions for making it viable, as described further above, are to become operative. It is left unclear, for the time being, whether the Union will adopt a unified currency of its own, or whether national currencies are to survive one beside another. The resolution provides for the formation of a joint network of central banks, whereas for delegating authority of financial policy making to Community agencies only very cautious declarations of sympathy can be read there. Even more nebulous are the Commission's commentaries on the subject of equipping the European Parliament with greater powers of control.

**Economists vs. Monetarists**

The Council's resolution had been preceded by exceptionally intense disputes about how to coordinate the diverse steps of development in economic and monetary questions during the "transition period". Monetarists and Economists staged clashes which made the two camps appear irreconcilable. Economists see in a monetary union only the crowning act of a process generated through progressively better and closer harmonisation of economic policies, and ending in a truly common monetary budgetary policy. Monetary union culminating in the unification of all Community currencies in a single one would then have only a more or less formal meaning of an actual coronation ceremony. The Monetarists, on the contrary, plead for setting up the monetary union as early as possible. Fixing firm exchange rates and abolishing margins for parity fluctuations, so they argue, would create an "automatism" imposing on economic policies their effective harmonisation, so that the monetary union acts as a "prime mover" towards a true union.

An examination of the Council's step-by-step plan does not disclose, however, much practical comment on the required "parallelism" of coordinating economic and monetary policies. Particularly disappointing is the paucity of the resolution in its remarks about establishing full transferability of capital within the Community. Its programme does not mention any suggestion about exerting even the mildest of pressures towards the dismantling of all the remaining obstacles in the path of convertibility, though progress from the status quo is so badly needed just here. During the first phase of three years, the Council's resolution also does not provide for much more than for closer consultation on problems of short-term economic policy. To connect these measures with the "Third Programme for a Medium Term Economic Policy", adopted in early 1971, has not meant either that member states have pledged themselves to firm and binding coordination of monetary and economic policies. The "Third Programme" is an attempt to use quantified data on the four major aims — full employment, stable prices, external equilibrium and economic growth — for advance coordination of the aims and thus the economic and monetary policies of member states more effectively than in the past. But also the "Third Programme" does not propose to adopt mandatory joint coordination measures.

On the other hand, the Council's step-by-step plan contains considerable concessions to the views of the Monetarists, for example: it has been agreed that maximum margins, within which currencies of EEC members may shift against each other, have been narrowed down to 2.25 p. c., by another Council resolution of March 21, 1972, whilst they may, as agreed at the Washington Conference, fluctuate jointly against the dollar by 4.5 p. c. Similar intentions are the basis for forming a "European Fund for Monetary Cooperation", and for agreements made simultaneously or even earlier about short and medium term mutual financial aid among EEC countries.

It is not surprising, after all these advance concessions in the monetary sector, that the Council's Plan contains also a precautionary clause, though it has been weakened against the original German demands. This clause restricts the duration of all


² Documents concerning this dispute and official texts are contained in: Rainer Heilmann, Europäische Wirtschafts- und Währungsunion (European Economic and Monetary Union), Series: Europäische Wirtschaft, Vol. 63, Baden-Baden, 1972.
the monetary measures, unless progress to the second planned stage is already decided upon, to a mere five years, because coordination with economic policy has not yet been achieved in obtaining complete parallelism of measures.

Soon after the adoption of the "Step-by-Step Programme", warnings could be heard against the EEC, instead of becoming an island of stability and growth in the middle of an inflationary world, growing into a Community of common inflation. Steep price rises of recent years in all the EEC member states have led to an increase of these fears.

The following components of a policy whose designated aim is the achievement of an economic and monetary union might accelerate this tendency: firstly, that the two credit agreements made between EEC members might facilitate the sliding down the slippery slope to such governments as show greater inclination towards inflation. Against these doubts, it has been argued that credits are granted in a restrictive way, so as not to undermine stability, but past practices have tended to confirm the sceptics' warnings. For during the very first of emergencies in which these measures should have operated at the moment when margins were narrowed, Italy managed to obtain specially favourable treatment, which pointed in exactly the dreaded direction. Moreover, the decision of the Paris Summit Conference to set up a European Fund for Monetary Cooperation already in April 1973, without previously insisting on practical precautions for closer coordination of monetary policies with financial policies, will reinforce this trend without doubt.

Narrowing the margins is generally considered to be the first step towards establishing firm and unchangeable rates of exchange, but just this step produces new and special problems. If rates of exchange are "frozen" before coordination of economic and monetary policies has gone very far as against present and rather unsatisfactory conditions, there will be a twofold incompatibility threatening the Community. Either the non-correspondence between economic and monetary policies will inevitably reproduce strong disequilibria between balances of payments, unavoidably followed by distortions of foreign trade and capital movements, waves of speculation, restricted convertibility, and sudden jumps in the rates of exchange. There is a hardly more attractive alternative available: that the more stability-conscious countries fall in step with inflation, as long as a coordinated economic and monetary policy aimed at joint stability remains a far and unattainable utopia.

Finally the lacking stability consciousness within the Community is also shown by the fact that up to now its members could not agree on a common protection — by exchange rate policies — against inflation possibly imported from third countries.

Priority of Politics

In the last analysis, all considerations of the problems encountered on the way towards an economic and monetary union will arrive at the truly crucial question whether there is a political foundation existing in the EEC member states upon which progress from the EEC as a mere customs union to an economic and monetary union may be built. When the customs union was set up, economics was the leading force but "only" in so far as the problem consisted in liberating market forces from the shackles of import duties and physical trade controls. The higher stage of integration — achieving an economic and monetary union —, however, requires institutional changes, notably the constantly mentioned common monetary and budgetary policies. It is the demand for a common budgeting policy by Community authorities that shows quite clearly the political character of the Economic and Monetary Union. If one ponders how much of national sovereignty must be surrendered when monetary and budget policies are to be largely controlled by Community authorities, complete success of such a project is almost inconceivable without a political union.

When the French attacked the outspokenness of the Werner Report which has been quoted above, this was no more than one additional proof for the fact that views about the desirable political form which the Community is to reach are still separated by deep chasms. The British contribution is not likely to strengthen the camp of those who want to build the political foundations upon practical decisions to be made now. In discussing final objectives, however, people frequently forget that even in the phase of transition no lasting progress can be made unless policy decisions enable politics to lift the barriers against taking practical steps. Therefore, perhaps only a few more years are left for making it possible for the Community eventually to become an economic and monetary union and ultimately a political union, or whether its integration will remain stuck in the present phase. But then, it must be clearly seen that without a closer coordination of economic and monetary policies, even the present state of integration might be lost again.

\[^{3} \text{For a discussion of this risk and of related problems, see Hans Willebrodt, Alexander Domasch, Rolf Hasse, and Volker Mertz, Wegen und Inneweg zur europäischen Währungsunion (How to Arrive, or How to Miss One's Way towards European Monetary Union), in: Beiträge zur Wirtschaftspolitik (Contributions to Economic Policy), Vol. 16, ed. E. Tuchfeldt, Freiburg, 1972.}\]