Address by Pierre Werner entitled ‘The outlook for European financial and monetary policy’ (Saarbrücken, 26 January 1968)

Caption: On 26 January 1968, Pierre Werner, Minister of State and President of the Luxembourg Government, gives an address in Saarbrücken at the CDU economic congress entitled ‘The outlook for European financial and monetary policy’. In this address, he sets out a ‘five-point action plan’ for European monetary integration based on the creation of a European unit of account, fixed exchange rates between European currencies, consultation, and internal and external solidarity between the Member States of the European Communities. He also raises the idea of a monetary cooperation fund.

Source: Bulletin de documentation. dir. de publ. Service Information et Presse-Ministère d'Etat. 26.01.1968, n° 2; 24e année. Luxembourg. "Perspectives de la Politique Financière et Monétaire Européenne", auteur:Werner, Pierre , p. 3-8.

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URL:
http://www.cvce.eu/obj/address_by_pierre_werner_entitled_the_outlook_for_european_financial_and_monetary_policy_saarbrucken_26_january_1968-en-9e4fdb06-ced8-4070-9012-f0242ac73321.html

Last updated: 05/07/2016

The outlook for European financial and monetary policy

Statement by Pierre Werner, Minister of State, Prime Minister and Minister for the Treasury

The demands of the common market

On 1 July this year, the free movement of goods between the Member States of the European Economic Community will become a reality. The gradual liberalisation that we have witnessed since the early days of the Community will thus culminate in a system of free trade with no direct discrimination to distort competition between producers and distributors in the various countries. However, will we then be able to claim that undertakings will pursue their activities in identical conditions? Of course not! The location of production, the level of investment and the rate of day-to-day economic activity are still determined, among other things, by the financial policies pursued in the various countries, and this is an area in which the individual countries continue to enjoy a large measure of autonomy under the Treaty.

However, the proper functioning of the economic union towards which we are moving will require further approximation in the field of public and private finance. All producers must be assured of access to capital markets within the Community on at least comparable terms. This is essential to the Community itself and to the more ambitious aim of using its economic clout to develop a financial concentration that would make it one of the largest financial markets in the world.

This ambition, to which recent events lend added urgency, calls for a fresh look at the policies to be pursued in the areas of fiscal and monetary coordination and harmonisation of credit and budget policies. Clearly these areas are, to some extent, interdependent. So it may confidently be stated at the outset that harmonisation and unification in the various financial sectors must proceed in parallel and at a regular rate.

Monetary policy

Is a Community policy really necessary?

It is sometimes claimed that monetary autonomy is the final bastion of national sovereignty. It is true that the right to issue coinage is one of the essential attributes of sovereignty, not only because of the prestige attached to issuing coins and banknotes bearing national emblems and symbols but, above all, because monetary policy is of paramount importance to the national economy and the conduct of the people. The sacrifices that a nation is asked to make in times of crisis often take the form of monetary manipulations.

Consequently, full monetary unification in Europe is likely to be dependent on further progress in the process of political unification.

However, it will not do to become fixed on this idea, which many monetary authorities find all too attractive.

The actions taken by the monetary authorities are not isolated economic phenomena. They influence economic life and affect the conditions of competition, either through changes in parity, i.e. devaluation or revaluation, or by increasing or reducing the credit directly or indirectly created by the issuing institution.

The aims of the common market require that undertakings and nationals of the various countries have equal opportunities in production and development, that all distortions in international trade be removed, that access to the Community’s available capital resources be assured and, lastly, that the economy of one Member State should not thrive at the expense of the others by the accumulation of an artificial and purely nominal reserve of credit.

Of course, all these problems could have been solved at a stroke by making the arrangements between the Member States contingent on monetary agreements or, better still, by establishing a common currency from very beginning.

Let me remind you that the Benelux Union was based on a monetary agreement concluded by the governments-in-exile on 21 October 1943.

Monetary unification is a highly effective, even brutal, way of securing economic integration. It forces the economy into a new mould by subjecting it to extreme tensions and pressures.

The provisions of the Treaty of Rome

The Treaty of Rome is remarkably cautious and unambitious on the subject of monetary unification. There are a number of reasons for this:

(a) It seemed wise not to weigh down the draft Treaty with psychological handicaps in an area where national sensitivities are still exceptionally tender.

(b) The international financial system rendered a more meticulous approach unnecessary, at least to some extent.

Since 1945, we have been living in the long shadow of the Bretton Woods Agreement. Under the Articles of Agreement of the International Monetary Fund, excessive exchange rate fluctuations are prohibited, and changes in parity are subject to consultation. In return, member countries may count on receiving financial support in the event of temporary balance-of-payments difficulties.

(c) In addition to IMF support, the European Payments Union system of payments, derived from the Marshall Plan, was still in operation when the Treaty was being drafted.

(d) In 1961, the Community Member States declared their currencies convertible within the meaning of the International Monetary Fund Articles of Agreement.

All these circumstances combined to limit the risk of monetary confusion or conflict among the Six.

In the Treaty itself, monetary coordination appears only as a corollary to the requirements of economic policy. Specifically financial commitments are somewhat vague. Article 104 gives a very general account of the objectives that a sound economic and monetary policy should pursue. I quote: ‘Each Member State shall pursue the economic policy needed to ensure the equilibrium of its overall balance of payments and to maintain confidence in its currency, while taking care to ensure a high level of employment and a stable level of prices.’ It could not be better put. Responsibility for currency and credit policy is still vested in the states, but they are invited to harmonise their action with regard to short-term economic policy and equilibrium in the balance of payments.

A Monetary Committee was set up under the Treaty to promote that harmonisation. The Committee is a purely advisory body, but it must be acknowledged that its opinions carry increasing weight. Over the past year, in particular, its studies and proposals have formed the basis for coherent action by the Six.

According to the text of the Treaty, the penalties for monetary misconduct are based mainly on self-defence. When an exchange rate is out of line or inappropriate, other countries may be authorised to take the necessary measures to counter the consequences.

Attention must nevertheless be drawn to the provisions of Article 108. Although they do not appear at first sight to be mandatory, they are capable of development into forward agreements. Where a Member State is in difficulties or is seriously threatened with difficulties as regards its balance of payments, and where such difficulties are liable to jeopardise the functioning of the common market, the Commission may make recommendations on the basis of Article 108, and the Council may grant mutual assistance and lay down the conditions and details of such assistance. It may take a variety of forms, some of which are listed in Article 108. There are also safeguard clauses to cover the eventuality of a sudden crisis.

The Commission's first recommendations

In 1962, as part of the programme of work to be completed during the second stage, the Commission submitted a set of recommendations with a view to the development of a Community monetary policy. It recommended that the regular monetary consultations between governments and central banks should be extended and intensified and that they should be mandatory in certain cases where important decisions were to be taken. It also recommended that the scope of the obligations that each country would be prepared to assume for mutual assistance under Article 108 should be set out in an intergovernmental agreement.

The Commission dwelt particularly on the problem of fixed exchange rates. I can do no better than quote a passage from the memorandum of 31 October 1962: 'Economic union, at least after the end of the transitional period, entails fixed rates of exchange between the currencies of the Member States, subject to variations within very strict limits. Any major alteration would have such serious repercussions for trade in countries no longer protected by customs barriers and would, as a result of the Community intervention price for grain and other basic agricultural products, lead to such abrupt changes in the level of agricultural production and consequently in farmers' incomes that the common market itself might be jeopardised.'

The Benelux countries solved the problem within the Benelux Union by strict undertakings, enshrined in Article 12 of the Benelux Treaty, not to alter their exchange rates save by mutual agreement. The Benelux Treaty goes much further than the Treaty of Rome in this respect.

The 1962 recommendations were not embodied in any formal agreements or sets of rules. Consultation between the monetary authorities was the main area in which they were followed to some extent in keeping with the spirit in which they had been put forward. Generally speaking, speculations about the Community's monetary future appeared for many years to be largely academic and of no immediate interest.

The monetary problem becomes topical again

Various events have recently revived interest in monetary integration within the common market.

1. The definition of the common agricultural policy has produced a state of affairs where any independent change in the parity of one of the six countries' national currencies would threaten the general equilibrium of their concessions. Farm prices are denominated in accounting currency or dollars, occasionally even in DM.

2. The six countries have been drawn into the arguments about the system of international liquid assets. They have had to take a position on the question of gold and the creation of a new reserve currency unit. Remarkably, the Six suddenly found they were united on a subject that they had previously approached in a highly individual manner. This gradually emerged during the regular meetings of Finance Ministers, notably in The Hague and Luxembourg in 1966. Despite some differences of opinion, the broad outlines of the common position that the Member States proposed to adopt in future discussions on international liquid assets in a wider arena were agreed at the meeting held in Munich on 17 and 18 April 1967.

The coherent views held by the six governments were confirmed during the preparations for the International Monetary Fund Assembly meeting in Rio de Janeiro in September 1967, at which the principle was determined of the establishment of special drawing rights on the International Monetary Fund was decided. In December 1967, the Six agreed in Paris on proposals for amendments to the IMF Articles of Agreement. One of these was to require a qualified majority for certain important decisions, on terms that would enable the Six to exercise a veto by combining their votes.

Once again, the EEC Member States found themselves united in international monetary matters and this unity, if it held firm, was bound to be reflected eventually in the Community's institutions and rules.

3. The United Kingdom application for accession means that the authorities of the Six will have to review

their monetary policy objectives. This is essential in the case of the United Kingdom, which will bring a reserve currency and a common world trade currency into the Community when it joins. The incorporation of this currency raises problems. There would also be problems within the Six if a stronger European position were to attract flows of capital into one or more Community countries, with the result that their currencies might be called upon to function at least partly as a reserve currency.

In the present confusion caused by recent differences of opinion on the negotiations with the United Kingdom, one of the practical steps that should be taken, and one which would have a salutary effect on the outcome, is to consider at once, in the light of United Kingdom accession, the role that world currencies and reserve currencies play in the Community and identify fresh opportunities for strengthening the cohesion between member countries that might result from closer coordination of monetary policies.

This proposal is in line with the Commission's view that 'no national currency may assume the role of a Community monetary system, which should come about through the gradual coordination of Member States' policies and the strengthening of common economic, monetary and financial policies.' It is also consistent with the repeated expressions of good will and open-mindedness on the part of the United Kingdom Government and monetary authorities, who are ready to discuss the role of sterling in an economic community.

4. Lastly, a flourishing European capital market cannot be created without closer coordination of monetary policies. The programme, announced by President Johnson on 1 January 1968, to improve the United States' balance of payments by reducing US capital investment, means that we must consider and develop the intra-European capital market which has been built up in a somewhat unconventional way over the past few years. I shall return to this later.

An action plan

Any move in monetary matters raises general policy issues. Nevertheless, given the history of the situations and the scale of the problems that I have just outlined, perhaps the time may has come for the Community to devise an action plan for this sector.

In the light of the actual problems generated by the current monetary situation, which are more acute now than they were in 1962, one approach would be to take up and adapt some of the suggestions which the Commission put forward at that time in its programme of action for the second stage. Other ideas have been floated since. Bolder proposals for monetary unification have been made.

Based solely on the imperatives of economic integration and the proper functioning of the international payments system, an action plan might be devised on the following lines:

1. Identify monetary operations that the Member States could undertake only after consulting their partners, either in the Council of Ministers, or in the Monetary Committee, or, possibly, in a special body comprising Finance Ministers and Central Bank Governors.

2. Define and approve a European unit of account, having first unified the wording employed in the European Treaties and various rules. The use of this unit of account in relations between the Six would develop quite naturally in keeping with the needs for Community action, both internal and external.

3. With or without reference to the accounting currency, the Six should define their reciprocal obligations to maintain fixed rates of exchange between their currencies.

Let us recall that the six governments defined their currencies' parity in relation to gold as part of their International Monetary Fund commitments.

4. Coordinate monetary cooperation among the Six with worldwide monetary cooperation through the IMF. This is essential for the attainment of the objectives of security and free trade recommended by the financial

bodies established under the Bretton Woods Agreement.

Consultation and coordination are of prime importance in relations with these bodies. The consultations of the past year should be continued and should become standard practice. They will take on special importance once the plan for new special drawing rights on the Fund is put into effect.

5. Draw up a forward plan for an intergovernmental agreement, to include in due course the scope of each country's obligations in respect of mutual assistance under Articles 108 and 109 of the Treaty.

Assistance could be organised through a Community instrument in the form of a European Monetary Cooperation Fund to act as a channel for two types of operation:

inward transactions, in which mutual assistance would correct any disequilibrium in the balance of payments, subject to coordination with drawing on the International Monetary Fund; and

outward transactions, that is to say international credit transactions arising either from the common commercial policy or from assistance to be provided under the international payments system.

I am not advocating undue haste in this matter. I believe that we should proceed in a gradual and orderly manner in accordance with the real needs connected with the functioning of our Community. Of course, the use of an accounting currency and various united institutional measures will bring us closer to the ultimate ideal of a system based on a European reserve fund and a European currency.

Free movement of capital and the capital market

The letter and spirit of the Treaty

The Treaty of Rome enjoins the Member States to endeavour to attain 'the highest possible degree of liberalisation' in respect of the movement of capital between those States and third countries. Thus, the Community intends to be, to a large extent, open to the outside world.

As regards movements of capital within the Community, Article 67 of the Treaty provides that, during the transitional period and to the extent necessary to ensure the proper functioning of the common market, Member States shall progressively abolish between themselves 'all restrictions on the movement of capital belonging to persons resident in Member States and any discrimination based on the nationality or on the place of residence of the parties or on the place where such capital is invested.'

In order to implement Article 67, the Council has already adopted, on a proposal from the Commission, two Directives dated 11 May 1960 and 18 December 1962 on the abolition of exchange restrictions. A third directive is still under discussion. Its aim is to establish a better balance between the commitments of the various Member States, notably by allowing foreign issuers to operate on national markets.

The drafting of this third directive raises particularly delicate issues. In point of fact — and this applies equally to the proposals for the harmonisation of direct taxes and charges connected with movements of capital — real liberalisation of capital, with equal opportunities for all, requires progress in the removal of barriers in many fields. It has implications for credit policy and the financing of national budgets.

The experts' report

The complexity and range of the approximation measures required to develop a European capital market are set out in the report submitted in November 1966 by a group of experts appointed by the EEC Commission (the Segré report).

The authors of the report took the view that the European capital market should, as far as possible, develop spontaneously. However, a conscious effort on the part of the public authorities and the financial institutions would also be needed.

In this connection, the following should be reviewed and, where necessary, harmonised:

— the tax arrangements applying to internal investment and investment in or by other Member States, and any differences in the tax arrangements applying to various types of investment;

— the special system of financial channels, in order to reduce the present rigid internal partitioning of markets;

— the rules restricting areas open to institutional investors;

— the exchange rules concerning movements of capital.

The euro-currency market

As far as spontaneous development is concerned, it is worth noting that a network of transactions that can properly be described as a European capital market has developed within the Community countries over the past few years. I am speaking of relationships formed for the purpose of issuing loans in euro-currencies. This market has its own idiosyncrasies and is bound to change, once there are no more injections of fresh capital from the United States. There will be a tendency to become even more Europe-oriented.

At present, it is important to master the techniques of this market and learn from it. It is the fruit of close collaboration between the financial institutions of various nations making the best possible use, in their principals' interests, of the instruments and the legal frameworks provided by the Community countries. It should also be noted that the success of this European market in its first incarnation is partly attributable to the use of a currency which served as a *de facto* accounting currency for the national currencies. I am speaking of the euro-dollar.

The prerequisites for a European capital market

The harmonisation of the tax arrangements applying to companies with share capital and securities plays a part in the balanced development of the common market. It must not, however, be forgotten that approximation measures sometimes have highly complex repercussions. Such measures must always be consistent with the objective of interpenetration of the European market and with the principle of openness and freedom on which it is based. Sources of double taxation must also be removed.

Closer cooperation between the supervisory authorities responsible for monitoring capital markets in the Member States will also be required, with a view to establishing a better basis for balance between existing national markets.

Fiscal and credit problems are only some of the difficulties that will have to be overcome if we are to establish a real capital market. The balance of public finances in the countries concerned is of prime importance for the proper functioning of the market. Accordingly, the Member States will also have to coordinate their budgetary policies.

Conclusion

In conclusion, I should like to quote Professeur Maurice Duverger, writing in *Le Monde* on 10 January 1968, who described the recent possibility of establishing a European financial bloc as a lost opportunity. 'We

have no assurance', he said, 'that our five common market partners are ready to join us in establishing a European monetary system that could match the dollar or that the United Kingdom is prepared to participate in such a system. Entrenched positions, habits of mind and differing interests all constitute obstacles that will not be quickly or easily overcome. But the conditions are right for making a start.'

The purpose of this statement is to stimulate interest in making that 'start'!