

Point of view of the Labour Committee for Europe (October 1978)

Caption: In October 1978, during the debates in the British Parliament on the European Monetary System (EMS), John Roper, Chairman of the Labour Committee for Europe, argues strongly in favour of the United Kingdom joining the EMS.

Source: Parliament-House of Commons-Expenditure Committee (Ed.). The European Monetary System, First report from the Expenditure Committee, session 1978-79, together with the minutes of the evidence taken before the General Sub-committee in session 1978-79 and appendices. London: Her Majesty's Stationery Office, 1978. 159 p. ISBN 0 10 206079 7.

Copyright: Crown copyright is reproduced with the permission of the Controller of Her Majesty's Stationery Office and the Queen's Printer for Scotland

URL: http://www.cvce.eu/obj/point_of_view_of_the_labour_committee_for_europe_october_1978-en-e7c7507d-0446-4c8c-85fd-6125b0303745.html

Publication date: 04/09/2012

Paper submitted on behalf of the Labour Committee for Europe by its Chairman, Mr John Roper, MP

Fundamentals

The fundamental aim of the European Monetary System should be to create a structure of permanent economic co-operation in Europe. The purpose of this co-operation should be to achieve such a balance of the economic policies pursued by the member countries as is best for the general advantage of all the countries, especially in attaining the highest feasible levels of employment and growth.

The aim of creating a zone of monetary stability in Europe should be seen as part of the fundamental aim, not an end in itself. The attempt to keep exchange rates together would be an indicator for economic decision-taking with the wider aim in mind.

It is clear that divergence of economic policies between the countries of Europe hampers the efforts of any one country to solve current economic difficulties. The benefit to the UK of being a member of successful EMS would be the improved chances of success for our own policies if they can be pursued in a European context of greater policy convergence — including, of course, the effect of such European convergence in improving world economic co-operation.

If the EMS were to turn out to be unsuccessful — to “collapse” — this should be judged not in terms of how often it had in the event proved necessary to alter exchange rates, but in terms of a failure of the members countries to reach agreement on a mix of economic policies that each country could accept as being in its own interests.

Whether the EMS will in fact take the shape and have the objectives that we have indicated cannot be settled completely before it begins operations. Whatever the prior agreements on aims and on technicalities, the nature of the scheme will be determined more by the decisions that are actually taken as it goes along.

Currency stability

What should be the aim of EMS in specific respect of currency stability? It should be the aim stated by the Chancellor of the Exchequer in his interview in “Socialist Commentary”, October 1978.

“There is no doubt that many of the currency fluctuations in recent years have not reflected underlying economic differences between the countries concerned ... the real question is whether we can find a system that gets rid of these erratic speculative movements in the value of currencies while allowing currencies to change their values when economic circumstances justify it. What people are asking for is not a zone of fixed parities in Europe, but a zone of currency stability.”

This would certainly be our view. Intervention in support of a currency (or to bring a strong one lower) should only take place to damp down fluctuations that do not represent, or are over-reacting to, underlying economic realities. The arrangements of the scheme should provide for a recognition that once an exchange rate is clearly inappropriate to economic realities, it should be changed.

This means that the UK should be arguing for a scheme that is as flexible as possible — meaning a scheme where rate changes take place with the minimum of formality, avoiding the presentation of speculators with a one-way option.

Business needs

Would this approach meet the need of improving business confidence and encouraging investment?

The weight of evidence from business seems to suggest that it would certainly be more convenient for business if there were a single European currency: rates of currency fluctuation either side of the central rate such as the “snake” margin of 2¼ per cent either way are in fact large enough to be a nuisance for business. But there is no question of being able to offer business greater fixity of rates than that.

Absolutely fixed rates not being on offer, the main business desire over exchange rates appears to be to prevent major divergencies appearing over relatively short periods (worst of all, sudden emergency changes). It is the development of such divergencies, or the fear of future ones, that is an obstacle to confidence for long-term planning and investment, rather than what are generally regarded as “fluctuations” in exchange rates. In effect, therefore, the main business need is not so much “currency stability” as convergence of economic policies and of the results of those policies.

Convergence in the EMS

The extent to which convergence of national inflation rates within the EMS can be achieved will be the main determinant of how far stable exchange rates can be maintained. Critics of the EMS scheme point at the existing wide spread of inflation rates in the European Community with the Germans currently running at about 3 per cent and the Italians about 12 per cent. They argue that this means either that it will not be possible to maintain a stable relationship of exchange rates, or that there must be a harmonisation around one rate of inflation for all countries in the EMS, with consequential difficulties for the countries having to make the biggest adjustments.

As we have already argued, if in fact rates of inflation continue to differ significantly, then it will have to be accepted that exchange rates will have to alter from time to time and the EMS would not try the impossible task of maintaining rates under the pressure of such divergencies, but merely aim at damping down speculative and other erratic fluctuations around these real trends.

But it has been accepted as an aim of national economic policy in this country that we should try to get our inflation rate down to a level reasonably in line with the inflation rates of our principle industrial competitors. Trying to do so within the EMS would simply be an extension of this established policy.

What appears to be the main fear in many people’s minds is that we would be trying to get our inflation rate down to that of Germany.

Even if this is accepted as a feasible long-term aim, to achieve it over any reasonably short period would obviously involve pursuing deflationary policies. And it is further argued that in fact this is not a suitable long-term aim: that structural factors in the British economy lead inevitably to our having a lower rate of productivity growth than that of Germany, and that, therefore, for us to aim at their rate of inflation would inevitably mean much more unemployment in this country. We do not accept this argument — in any case it depends on the income growth aimed at — but if true it would just be one of the realities that must govern the workings of the EMS. It does not mean that we should not aim at getting our inflation rate as close to that of the Germans as is compatible with the underlying productivity factor. And this would be true whether we were in the EMS or not.

But it is fallacious to assume that an EMS would simply be a “snake” on a larger scale, whether in terms of its technicalities or in respect of the extent to which it is dominated by Germany. Throughout most of its history the snake has in fact been the D-Mark surrounded by satellite currencies. This has been a reflection of the relative sizes of the countries concerned.

But in an EMS that included Britain, France and Italy, Germany with its very low rate of inflation would be the odd man out compared to the three others with significantly higher rates. Although we shall all be aiming at reducing inflation next year, with France likely to make a particularly strong attempt, any idea of a harmonised rate of inflation would clearly be pitched at a level significantly above the 4 per cent that at present seems likely to be the German rate next year.

This no more means that under the EMS scheme Germany would automatically have its inflation forced up than it means that Britain, France or Italy would have our inflation rates forced down. But it does mean that in the discussions of economic policy that would take place in the EMS — the discussions about what to do in response to an observed tendency for exchange rates to come under pressure driving them apart — the German interest in a very low inflation rate would be the minority view. This is certainly recognised in Germany. Whilst some people in Britain fear that membership of the EMS would be deflationary on us, the five leading German economic institutes take the view that the effect on Germany would be inflationary.

What should in fact be envisaged is that in the discussions within the EMS the aim would be to seek a compromise that was of positive benefit to everybody. This might well not be possible, in which case exchange rates would have to move apart. But it is certainly conceivable that we might see ourselves as likely to achieve sufficient benefit from a degree of German expansion that we could envisage agreeing as a quid pro quo a somewhat tighter monetary policy than we would otherwise have thought appropriate to our needs.

The question of “symmetry of obligation” under the EMS should be seen primarily in this context of the balance of political interests within this scheme. It is also to some extent a matter of the technical arrangements and, in particular, of the role of the “basket” supplementing that of the grid, but even here the extent to which the grid imposes non-symmetrical obligations has been exaggerated. The fact that the snake has worked this way is the result of the basic imbalance mentioned above rather than because it is based on the grid mechanism.

Conclusion

Most of the doubts about the EMS that have been expressed in the United Kingdom result from an exaggerated attention to technical factors and an ignoring of what the fundamental political realities will be.

The present state of the negotiations does not contain any obstacle to the EMS working along the lines indicated in these notes. That being so it is clearly in Britain’s advantage to join. Inside the scheme we would be able to enjoy the benefit of joint support in preventing speculative raids on sterling. We would be able to seek help from our partners for dealing with a genuine short-term economic problem, instead of having to run to the IMF. And we would be an integral part of any discussions of joint action for the economic future of Europe — discussions that could not help but be of vital interest to our well-being. If we were to stay outside sterling would be more exposed to speculative pressures: we would be more likely to find our long-term economic plans disrupted by the need to cope with a sudden monetary crisis and we should be on the outside looking in on the long-term economic planning for Europe.

October 1978