Economists v. monetarists — agreements and clashes in the drafting of the Werner Report

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Economists v. monetarists — agreements and clashes in the drafting of the Werner Report [1]

The work of the Werner Committee, the discussions, debates and negotiations in the group of experts, and the ensuing agreements and arguments about the points at issue gave rise to clashes over the idea of currency as the principal vector for the integration process.

There were generally two opposing points of view, two contrasting ways of thinking.

On one side, there were the ‘monetarists’ (whose standard-bearers were the countries with weak currencies), who argued for ‘institutions’. To their way of thinking, the priority should be to set up institutions and lay down requirements to be met. After that, there would be a coordinating of economic policies, driven forward by concerted action on the single currency which would already exist. The ‘monetarists’ thought that the only way to give any credibility to the prospect of monetary union and influence the behaviour of players in the economy was to set a timetable and lay down some rules of conduct. On the other side were the ‘economists’ (the countries with strong currencies). According to them, a convergence of economic policies — monetary and budgetary policies — was vital and must come before the setting up of institutions. A single currency would come only at the end of the process, as the ‘finishing touch’ to a harmonisation which would already have been carried out. [2]

In the Werner Group, economist positions were supported by the Germans — in particular, Finance Minister Karl Schiller, who tabled several documents on behalf of his government, including a ‘German plan for monetary integration’published on 12 February 1970 [3] — and the Dutch. They were joined by the Italians, whose position on economic and monetary union, influenced by both economist and monetarist views, [4] evolved over time. [5] They thought that ‘the fact that the word *economic* comes before the word *monetary* in the expression *economic and monetary union* proved that monetary union should come after economic union’. [6] The French and the Belgians (Baron Ansiaux) sided with the monetarists in considering that the economy is led by deliberate monetary decisions. For them, therefore, the priority was quick decisions on the margins for fluctuation between European currencies, concerted monetary action and the establishment of a reserve fund. Through his earlier public speeches and writings, Pierre Werner had tended to side with the monetarists. In discharging his duties as chairman of the group of experts, however, Werner chose to remain neutral, advocating a parallel approach to economic cooperation and monetary coordination as the underlying principle for the group’s reflections.

These different views on the method of achieving economic convergence and thus promoting integration actually hid the divergences between France and Germany. The approach of the ‘French monetarists’ was the exact opposite of that of the ‘German economists’ as regards the political objectives to adopt. The perception supported by France was that of an economic and monetary union which, at the monetary level, guaranteed a fixed-rate Community system while allowing countries to hold onto national sovereignty over economic and financial policy. In such a system, ‘the formal maintenance of national autonomy means little since, because of the mechanism acting at the short-term, monetary level, what happens is […] a forced alignment at the average level dictated by the economic climate at the time'. [7] This kind of forced harmonisation was against the interests of countries moving towards stability, such as Germany, which was convinced that monetary union without economic harmonisation was doomed to fail or to fall by the wayside. Germany also believed that countries going through balance of payments problems, like France, acted in favour of monetary union 'so that they would be able to solve their problems without reforming their economic policies and by relying on European reserves which would basically be German reserves'. [8]

Another sensitive point which was argued over was the existence of a supranational decision-making body for economic and monetary policy. During discussions in the Werner Committee, the German Minister for Economic Affairs and Finance, Karl Schiller, advocated strong coordination of domestic budgetary policies at the European level, which meant a political authority alongside the future Central Bank. France was fiercely opposed to this, as it wished to avoid national sovereignty being too severely truncated in this area.

The clashes between economists and monetarists among the Six had started to emerge long before [9] the Werner Group started its work, as the debates around the first Barre Plan [10] and the attitudes to it clearly show. Following the recommendations in the Barre Plan for greater integration of the economies and the need for convergence, the Community countries reached agreement with the Council of Ministers' decision of 17 July 1969. The Germans advocated ongoing, parallel development and medium-term policy coordination. The Belgians, the Dutch, the Italians and the Germans agreed on non-automatic short-term support. The Luxembourgers took a balanced, middle course. The Benelux countries also adopted a common position, calling for the veto on British accession to be lifted before any negotiations on further European integration. The representatives of the central banks had serious reservations about monetary cooperation, though they were finally won over to the view of the Monetary Committee and suggested monetary solidarity through the establishment of medium-term support and flexible exchange rates.

During the course of 1969, the debate was fanned on one side by the monetary difficulties caused by the floating of the franc and the West German mark, and on the other by the almost simultaneous change of leadership in France and Germany. The accession to power of Georges Pompidou [11] gave fresh impetus to France's action on behalf of Europe. The French view on economic integration was that 'the argument now is not only between economic coordination and monetary cooperation but between accepting a little flexibility and monetary cooperation. The option now is a minimum scenario leaving countries a wide margin for manoeuvre'. [12]

The new German Chancellor, Willy Brandt, [13] wanted to embark on a course of active diplomacy, and model cooperation with France was a vital part of his foreign policy, especially since Pompidou's accession to the French Presidency seemed to favour that prospect. The Chancellor — who was in regular touch with Jean Monnet [14] — was convinced that setting up a real monetary dimension was a way of deepening the process of Community integration. The German Minister for Economic Affairs and Finance, Karl Schiller, took a different view of the matter and did not share the Chancellor's enthusiasm.

What is more, Brandt regarded the deepening of the EEC — especially in economic and monetary terms — as being less important than its enlargement. [15] This lack of domestic consensus caused the German Government to adopt a sceptical attitude to the feasibility of European economic and monetary projects. It was against this backdrop that Pompidou's proposal for a meeting of the Heads of State of the Europe of Six to discuss the 'completion, deepening and enlargement' triptych was made and the resulting summit meeting at The Hague was held on 1 and 2 December 1969. That meeting tasked the Council, working closely with the Commission, with looking into ways of making progress towards economic and monetary union by stages. A group of experts — the Werner Committee — subsequently came into being.

Going beyond their opposing views and differences over doctrine and political action, 'at the beginning of the 1970s, the Franco-German duo therefore thought that Europeanising the common market through expansion should be the priority and that economic and monetary Europeanisation should be a secondary issue.' [16] The main challenge was to pave the way for an area of consensus, an understanding between two diametrically opposed ways of seeing economic and monetary affairs.

This concerted tactical behaviour was permeated with a concern for the respective national interests of the two countries, but also influenced by the fact that minds at the time were focusing on the enlargement negotiations between the European Economic Community and four candidate countries — the United Kingdom, Ireland, Denmark and Norway. [17] The Werner Plan as written bears the imprint of this superficial Franco-German agreement on a monetary deepening of European integration. National stances heavily pervaded the attitudes of the Werner Group members, who, 'although […] appointed because of the posts they held in the Community, put forward arguments which increasingly reflected the concerns of their governments'. [18]

After seven months of work, discussions, arguments, horse-trading and reversals, a consensus was hammered out in the group of experts and the Werner Report [19] was approved. On 8 October 1970, Mr Werner, the group chairman, presented it publicly in Luxembourg. The compromise which made approval of the Werner Plan possible was very probably a precarious compromise, obtained by opting for the lowest common denominator. [20] The guiding principle behind the devising of the plan by stages — an evolving plan in three stages over a ten-year period — leading to the establishment of an economic and monetary union, was 'real parallel movement' on economic policy and monetary policy. The first of the three stages, described in painstaking detail and recommended for implementation in 1970–71, provided, with perfect symmetry of action, for increased economic policy coordination coupled with greater consultation in the area of monetary relations. The question of whether the 'European Monetary Cooperation Fund' was to be set up as early as the first stage or only during the second was left open. The 'irrevocable setting of parity rates' — or even a single currency — was supposed to come as the culmination of the process in 1980. For the final stage, the

Werner Plan saw a transfer of power from the national to the Community level, through the setting up of a decision-making centre for economic policy answerable to a European parliament, as essential, and took the same view on the setting up of a Community system of central banks. [21]

In Germany, the Werner Plan was seen as serious and well-balanced and, all in all, reactions to it were positive. Speaking in the Bundestag in 1970, Chancellor Brandt described the plan for economic and monetary union by stages as ‘the European Community’s new Magna Carta’. [22] In a letter to the German Finance Minister, Karl Schiller, a few days after the public presentation of the plan by stages, the Chancellor made clear that he was aware of how important it was to the cause of European integration and said he believed that its final adoption by the Council — if possible, by the end of the year — would ‘very probably [be] the most important decision since the signing of the Rome Treaties’. [23] Karl Schiller was on the same wavelength: a staunch supporter of the plan by stages, he regarded it as the ‘leaven in the mix which would lead to political union’. [24] Schiller also stressed the need to remain true to the objective of stability as ‘the indispensable condition for the transition from the first to the second stage’ [25] of the Werner Plan.

The Bundesbank, although it was in favour of a movement towards economic and monetary union by stages, was primarily concerned with safeguarding monetary stability during this process. The discussions of this issue in the Bundesbank’s *Zentralbankrat* centred on two demands in relation to the system proposed by the Werner Plan. Firstly, margins for fluctuation should not be reduced until after there had been genuine harmonisation of economic and financial policies. Secondly, the future council of the chairmen of the central banks should, from the outset, be responsible for laying down monetary policy guidelines, independently of the Council of Ministers, though they should nevertheless take the Council’s guidelines for economic policy into account. The Bundesbank’s leaders firmly believed that future monetary policy should be the responsibility of Europe’s central bankers collectively. [26] What made the German Central Bank’s view especially important was that the Bundesbank was expected to serve as the model for the future European Central Bank. [27] Both the minister and the Bundesbank were critical of statements by the Commission, which seemed to want to favour the monetary cooperation aspects at the expense of economic harmonisation and to be attacking the autonomy of the national central banks right from the first stage of the establishment of economic and monetary union. [28]

In France, discussions on the Werner Plan focused on different issues. President Pompidou did not think that transferring vital powers over monetary matters to the Community institutions — as planned for the second stage — was either realistic or desirable. To him, only economic and financial cooperation as part of the first stage seemed realistic. As to how this integration would develop in the future, Paris wanted to give as few undertakings as possible, thereby calling the single currency — the very essence of monetary integration — into question. This disavowal of the Werner Plan is even more surprising when we consider that it had been drawn up with input from the French representatives, just like the interim report, which had been agreed to by the ministers responsible. We know that President Pompidou expressly gave orders for the negotiations not to be brought to a conclusion, as had been planned, at the Brussels Council of Ministers on 14 December 1970, as a sign of his disagreement with the 'European jokers' whom he believed he had identified, especially among the politicians from the Benelux countries. [29] This is why the French delegation at the Council meetings of 23 November and 14 December 1970 was extremely reluctant to agree to successive transfers of powers to the Community institutions while at the same time rejecting the idea that there should be automatic transition from the first stage to the second. Germany, meanwhile, expressed reservations about the financing clauses as long as there were no tangible achievements to show in relation to policy coordination.

Although the objective of the plan for economic and monetary union was medium-term integration, actual agreement between the European partners went no further than the first three-year stage. With hindsight, the idea of setting up economic and monetary union in a decade looks somewhat out of step with the difficult situation in Europe at the time: the approach was probably over-optimistic. Even so, the original plan had the advantage of giving a focus to discussions and marking out a forward-looking vision.

The Council of Ministers of the Community officially ratified the plan for economic and monetary union on 22 March 1971. However, developments in the international monetary system, which went into full-blown crisis mode after the US decision on 15 August 1971 to devalue the dollar, would thwart the shared ambition set out in the Werner Plan, already weakened as it was by the absence of any real political will.

[1] Unless otherwise indicated, the source of all the documents cited in this study is www.cvce.eu.
[2] In the theoretical discussions on European integration, the positions advanced by the economists and the monetarists had different connotations from those put forward by Milton Friedman (1912–2006), winner of the Nobel Prize for Economics (1976) and founder of the 'Chicago monetarist school'. To him, 'monetarism', which originated in the ideas of the 17th and 18th century, was a term designating a school of thought which became established at the end of the 1960s and which saw government action in the monetary sphere as pointless, not to say pernicious. Milton Friedman became the leading light of this movement in seeking to rehabilitate the quantitative theory of currency as opposed to the dominant paradigm of the age, Keynesianism (a school of thought founded by the British economist John Maynard Keynes: 1883–1946). According to monetarist theory, the currency supply is exogenous (determined by the central bank); the demand for currency is stable; inflation is 'everywhere and always a monetary phenomenon', due to an over-rapid increase in the money supply (the means of payment in circulation); people make anticipatory adjustments which, in the long term, diminish the effects of short-term policies; there is a natural rate of unemployment below which the economy cannot fall sustainably. Keynesians thought that the markets, left to themselves, do not necessarily lead to the optimum economic result. In the economic field, the State must intervene, particularly as part of a policy to stimulate the economy.
[3] In the *Tagesnachrichten* (Daily Reports) of the Federal Ministry of Economic Affairs, 27.2.1970, No 6122. Reproduced in Tietmeyer, Hans, *Währungsstabilität für Europa. Beiträge, Reden und Dokumente zur europäischen Währungsintegration aus vier Jahrzehnten*, Nomos, Baden-Baden, 1996, pp. 88–94.
[4] See Tsoukalis, Loukas, *The Politics and Economics of European Monetary Integration*, Allen & Unwin, London, 1977. The author sees Italy as one of the 'economist' countries, alongside Germany and the Netherlands; one particular example mentioned is its opposition to the EMCF. But the Italian representative on the Werner Committee (Gaetano Strammati, Chairman of the Budgetary Policy Committee) was seen as siding with the 'monetarists'. See Werner, Pierre, *Itinéraires luxembourgeois et européens. Évolutions et souvenirs: 1945–1985*, 2 volumes, Éditions Saint-Paul, Luxembourg, 1992, Volume 2, p. 124.
[5] See Maes, Ivo and Quaglia, Lucia, 'France and Italy's Policies on European Monetary Integration. A Comparison of "Strong" and "Weak" States', in *Comparative European Politics*, Palgrave Macmillan, Volume 2, Number 1, April 2004, pp. 51–72. According to the authors, when the Werner Committee began its work, Italy adopted a nuanced, central stance, positioning itself between Belgium, Luxembourg and France on the one hand (seen as being 'fervent optimists'), and Germany and the Netherlands on the other (seen as 'positively cautious').
[6] Tietmeyer, Hans, 'L'union économique et monétaire au centre du débat politique', in *Hefte*, Institut für Wirtschaftspolitik, Cologne, No 1/1971, p. 18
[7] Ibid, p. 22
[8] Lefèvre, Sylvie, 'Les ministères de l'Économie et des Finances allemand et français dans la mise en place de la CEE: politiques et compétences', in *Le rôle des ministres des Finances et de l'Économie dans la construction européenne (1957–1978)*, Comité pour l'Histoire économique et financière de la France, Volume I, Paris, 2002, pp. 73–84
[9] This type of discussion had actually taken place at the economic and monetary conference held in London in 1933 and the Congress of Europe in The Hague in 1948. See the article by Clavert, Frédéric, 'Expérience économique de l'entre-deux-guerres et projets européistes', in Guieu, Jean-Michel; Le Dréau, Christophe (Ed), *Le Congrès de l'Europe à La Haye (1948–2008)*, PIE-Peter Lang, Collection: Euroclio — Volume 49, Brussels, Berne, Berlin, Frankfurt-am-Main, New York, Oxford, Vienna, 2009. 427 p.
[10] 'Memorandum on the coordination of economic policies and monetary cooperation within the Community'. This document, which was submitted by the Commission to the Council on 12 February 1969, bears the name of its prime mover, Commission Vice-President Raymond Barre. In EEC Bulletin Supplement No 3/1969, p. 13. (Document consulted on 10 October 2012.)
[11] Following the election of 15 June 1969, Georges Pompidou, formerly Prime Minister to General de Gaulle, became President of the French Republic.
[12] Bossuat, Gérard, 'Le président Georges Pompidou et les tentatives d'Union économique et monétaire', in *Georges Pompidou et l'Europe. Colloque 25 et 26 novembre 1993*, Association Georges Pompidou (Ed), Complexe, Brussels, 1995, p. 409
[13] On 21 October 1969, Willy Brandt was elected as the fourth Chancellor of the Federal Republic of Germany after the federal elections on 28 September of that year.
[14] 'On 31 October 1969, Monnet sent the Chancellor, who had only just taken office, a detailed memorandum on the advantages and the practical workings of the European Fund. A week later, on 7 November, Brandt and Monnet had a long discussion in Bonn in which Monnet did his best to dispel some doubts his interlocutor had as to the reaction it would get from German experts, the consequences of the plan for British membership and the attitude the United States would probably take. On 9 November, in a handwritten note, Brandt himself summarised the functions and aims of the European Fund and the disagreements it would be bound to trigger...'. Wilkens, Andreas, 'L'Allemagne et le projet d'union économique et monétaire (1969–1972)', in Bossuat, Gérard; Wilkens, Andreas (Ed), *Jean Monnet, L'Europe et les chemins de la paix*, Publications de la Sorbonne, Paris, 1999, 540 p., pp. 466–467
[15] Wilkens, Andreas, 'L'Allemagne et le projet d'union économique et monétaire (1969–1972)', in Bossuat, Gérard; Wilkens, Andreas (Ed), *Jean Monnet, L'Europe et les chemins de la paix*, Publications de la Sorbonne, Paris, 1999, 540 p., p. 468
[16] Frank, Robert, 'Pompidou, le franc et l'Europe 1969–1974', in *Georges Pompidou et l'Europe. Colloque 25 et 26 novembre 1993*, Association Georges Pompidou (Ed), Complexe, Brussels, 1995, p. 349

[17] The negotiations for the accession of the United Kingdom, Ireland, Denmark and Norway began in June 1970 and culminated in the first enlargement of the European Economic Community in January 1973. This first Common Market enlargement involved the UK, a great European nation and medium-sized power, a winner of the Second World War, a member of the UN Security Council, head of the Commonwealth, a leading financial centre and a key member of the European Free Trade Association. In the 1960s, two applications for membership from the UK had come to nothing, paralysing a fair amount of intra-Community business.

[18] Werner, Pierre, *Itinéraires*, Vol. 2, p. 124

[19] '[Report to the Council and the Commission on the realisation by stages of economic and monetary union in the Community (Werner Report)]', Luxembourg, 8 October 1970, Document L 6.956/II/70-D, in Official Journal of the European Communities, No C 136, Bulletin Supplement 11/1970, Luxembourg, 11 November 1970, p. 14. (Document consulted on 10 October 2012.)

[20] See section 3, 'The Werner Report'.

[21] For a better understanding of the debates surrounding the transfer of powers between the national and Community levels, it is helpful to refer to the theory of 'fiscal federalism' developed by the Canadian economist Robert Mundell. According to Mundell, the following three conditions cannot all be satisfied together: free capital flows, exchange rate stability and domestic autonomy in monetary policy. The third of these factors is incompatible with the other two. In 1970, Robert Mundell (who won the Nobel Prize for Economics in 1999 and wrote *A Theory of Optimum Currency Areas* in 1961) was a consultant to the EEC Monetary Committee and, as such, in 1972–73 he was a member of the EEC Study Group on Monetary Union.

[22] 'Declaration on European policy, 6 November 1970', in Brandt, Willy, *Reden und Interviews*, Vol. I, p. 238

[23] Letter from Willy Brandt to Karl Schiller, 21 October 1970. Historical Archives of the Bundesbank, N.2, Vol. 156. Quoted by Wilkens, Andreas, 'Une tentative prématurée? L'Allemagne, la France et les balbutiements de l'Europe monétaire (1969–1974)', in du Réau, Élisabeth; Frank, Robert (Ed), *Dynamiques européennes. Nouvel espace. Nouveaux acteurs. 1969–1981*, Publications de la Sorbonne, Paris, 2002, pp. 77–103, p. 87.

[24] Schiller, Karl, 'Speech before the Bundestag, 6 November 1970', in *Deutscher Bundestag. Stenographische Berichte*, Deutscher Bundestag, 6th legislature, pp. 4294–4297

[25] Ibid.

[26] See Wilkens, Andreas, 'Une tentative prématurée? L'Allemagne, la France et les balbutiements de l'Europe monétaire (1969–1974)', in du Réau, Élisabeth; Frank, Robert (Ed), *Dynamiques européennes. Nouvel espace. Nouveaux acteurs. 1969–1981*, Publications de la Sorbonne, Paris, 2002, pp. 77–103.

[27] The Minister for Economic Affairs, Karl Schiller, had undertaken before the *Zentralbankrat* of the Bundesbank 'to recommend the independent central bank as a model for the future European Central Bank'. Wilkens, Andreas, 'Une tentative prématurée? L'Allemagne, la France et les balbutiements de l'Europe monétaire (1969–1974)', in du Réau, Élisabeth; Frank, Robert (Ed), *Dynamiques européennes. Nouvel espace. Nouveaux acteurs. 1969–1981*, Publications de la Sorbonne, Paris, 2002, pp. 77–103

[28] See Clavert, Frédéric; Feiertag, Olivier (Ed), 'Les banquiers centraux dans la construction européenne', in *Histoire, économie et société. La revue d'histoire économique et sociale du XVIe au XXe siècle*, No 4/2011, ISSN: 0752-5702, Éditions Armand Colin, Paris. Also available at: [Central bankers and European integration — Study day] (consulted on 10 October 2012).

[29] Ibid.