Personal

The Case for More Intra-European Monetary Cooperation

Summary of Comments Made in Copenhagen on April 7, 1978

1. I am not satisfied with the rates of growth we are likely to realise in Germany and in the Community in 1978. But I simply cannot see how we can achieve a higher rate in Germany without a higher rate in the Community. Last year, at the London Summit, I promised I would take further action if we failed to meet our growth projections. In the event, such action was taken rather rapidly by act of parliament effective before the end of calendar 1977 and it has begun to show its effects. German GNP increased at an annual rate of 6 per cent in the last quarter of 1977. But because of the currency turbulences, below-average temperatures and industrial strife in some sectors the results for the first quarter of 1978 will be much less favourable. This cannot be cured by taking a few quick "growth decisions" which I would be delighted to take if only somebody could tell me how to reach 4 or 5 per cent of growth.

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The lesson we have all learnt in the past few years is that growth cannot be ensured by taking some Government decisions. Particularly in an open economy, strongly dependent on world market conditions, growth is the outcome of a very complicated process to which Government decisions can contribute but which they cannot control. It is for this reason that I am very reluctant to agree to a quantitative growth target for the Community as a whole; it may very well be that we are already proven wrong a month from now.

I am fully aware that in 1977 intra-Community trade has increased less than world trade. This is a great challenge to all of us but I wonder how close the relationship between intra-EC trade and GNP growth really is. The structural crisis which we are going through probably reached its lowest point sometime in the second quarter of 1975. If I take the ten-quarter period from 1975 II to 1977 IV, real GNP in Germany has risen slightly in excess of 10 per cent but the volume of our imports from EC countries has increased by almost 30 per cent. Would our imports have been significantly higher if GNP had increased by 12 rather than 10 per cent ? I doubt it and I am sure you will agree with me.

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I would like to add that we should not accept our trade deficit vis-à-vis the OPEC countries as an act of God. Germany has wiped out its bilateral deficit with OPEC, which had tripled between 1973 and 1974. We hope that other member countries will soon be able to do the same.

2. How did we get into this mess ? The first thing that comes to my mind is US inflation. During the Vietnam-years too many greenbacks were spread around the world. The Euro-Dollar market was created. We were worried about it at that time, small as it was by today's standards. But today the Euro-Dollar market has been extended from London via Luxembourg to the Carribean and Hongkong. It may reach 600 billion dollars this year, and I would not be surprised if it were to reach a trillion dollars in the early eighties! Since 1971 (abandonment of gold convertibility) and even more so since 1973 (abandonment of par values of the dollar) there are no longer brakes and limitations or even countervailing powers.

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It was this increase in international liquidity which made the enormous increase in oil prices possible, and I am afraid that we will experience more of the same. Last year international monetary reserves increased by about 55 billion dollars, the highest increase in a single year ever recorded. To a great extent, this is a reflection of the US balance-of-payments situation. In 1977 the US trade deficit was some 30 billion dollars and the current account deficit amounted to 20 billion dollars. But the US also had a 15 billion dollar deficit on its capital account. Thus the overall deficit was 35 billion dollars. And who financed this enormous deficit? Essentially the central banks of Japan, Switzerland, the Netherlands, the United Kingdom and Germany and ~~a~~ some other G 10-countries which bought a total of almost 36 billion dollars (net) last year and reinvested ~~some~~ a large portion of it in Treasury Bills so that the US and the American administration did not have to worry too much about the US balance-of-payments deficit.

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The Bank of England alone bought 16 billion dollars. Can it do the same in 1978 ? Of course it cannot. Just as the Bundesbank cannot continue to buy dollars on the same scale as [illegible] in the last six months. And without a dramatic turnaround in US policies regarding energy and inflation the likely result will be a further decline in the exchange rate of the dollar and a further erosion of confidence in what used to be <u>the</u> store of value for people all over the world. And countries whose currencies will follow the dollar will experience a higher rate of inflation than those whose currencies appreciate against the dollar. If Germany can keep its rate of inflation to about 3 per cent in 1978 and if the Swiss rate is even lower, this is largely the result of the upward float of our currencies which has lowered import prices. To a certain extent, Denmark, Norway and the Benelux countries have followed the same policy - with similar beneficial effects.

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3. But the currency situation is not the sole cause of the structural crisis we are facing. We all experience certain difficulties in industries like steel, textile, shipbuilding and footwear. All these industries face severe competition from developing countries or, more generally, from lower cost/lower price countries. In a way this competition is of our own making. We made the capital and the technology available to many of these countries and they combined it with cheap labour. It is obvious that one day the developing countries will be more competitive than we in additional fields as well. The answer to this problem is not protectionism, trade war, etc. The answer is adaptation of our industries and concentration on those sectors where we can hope to remain superior and competitive for some time. In this process we must fully take into account the interdependence among the Nine, and before long the Twelve.

4. The question is what we can do to turn the tide. Closer monetary cooperation would seem to be an obvious candidate but we will probably have to move beyond

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monetary matters proper. We may also have to move beyond the snake (which by the way is an obsolete word since there is no longer a tunnel) and think of a new animal altogether. We have most of the instruments already at hand.

I am referring for example to the European Investment Bank (EIB). Tomorrow we are going to approve a doubling of the capital of the EIB. The question is whether the EIB should continue to borrow dollars and pounds and marks or whether it should issue bonds and make loans denominated in European Units of Account (EUA) to finance additional investment, and thus create additional employment, in certain regions and certain sectors of the Community. In this connection we may also wish to reconsider the question whether interest payments on EIB loans should be subsidised out of the Community budget.

We already have, on paper at least, a European Monetary Cooperation Fund and we could transform this Fund into a European Monetary Fund based on the European Unit of Account (EUA).

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There are many things one can do in this field with the existing instruments. One need not do away with all our national central banks as Roy Jenkins has proposed. I would not go so far as that. But whatever we do must be practical and credible and that means we will probably have to think somewhat bigger than we have been accustomed to in this field. It is not sufficient to draw up emergency plans for 1978. Whatever plans we draw up must deal with our immediate problems but they must also go beyond 1978 and try to tackle the problems of the eighties' as well.

5. There are plenty of ideas around. The central idea is for the Community to pursue a <u>joint exchange rate policy via-à-vis third countries.</u> This is not a new idea but the division of our countries into snake countries and those outside the snake has made such a policy virtually impossible. There is the idea that we in Europe should reconstruct the Bretton Woods system amongst ourselves, i.e. establish parities for our currencies and very narrow margins around them. I am not sure whether all of us could actually

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live with very narrow margins, narrower than hitherto in the snake, but the alternative of establishing only a very loose relationship between the member countries inside the snake and those outside the snake does not strike me as being terribly meaningful. Thus we may have to strike a balance somewhere.

If we want to maintain greater exchange rate stability between our currencies we will have to intervene in the exchange markets and we will need the means to do so. Fortunately we already have a number of support mechanisms in the Community which we can draw upon:

- the very short-term (automatic within the snake) monetary support (30 days),
- the short-term monetary support (3 months with the possibility of a renewal),
- the medium-term financial assistance (2 - 5 years).

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Some of these mechanisms have recently been increased. Whether they would be sufficient to support a closer system of monetary cooperation will have to be examined.

In addition we have the Community loan facility which was originally conceived as a European oil facility and which could be expanded. We might also wish to study whether we also need a long-term (5 - 10 years) support mechanism; I would assume that the EIB can take care of most such requirements.

6. All of this could go along with a larger role for the EUA which might well become a monetary instrument peculiar to the Community. The instrument would be issued by the European Monetary Fund in exchange for national currencies and it would be used for transactions between the central banks of the Community. It would replace the dollar as a means of settlement.

We could also entrust to the European Monetary Fund the task of managing the value of our currencies in relation to the dollar, yen, etc. If we were to do

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so we would have to pool a certain fraction of our reserves. And add some of our own currencies. Germany would be willing to do so.

Eventually the EUA might become a reserve currency; OPEC countries might be interested to invest a part of their surplus in EUA. And anyway some time in the future the Fund might issue EUA-denominated special drawing rights to its members.

While full membership would be confined to Community countries, other countries might become affiliated. Certainly Norway by virtue of its membership in the snake; others like Austria or Switzerland might seek such a relationship at a later stage or might cooperate de facto.

7. The scheme would not make the International Monetary Fund obsolete. The IMF would have to monitor and coordinate the exchange rate policies of Japan, the US and Europe. For many countries it would continue to be the lender of last resort, namely for those who have no one else to turn to.

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It would have to continue to act as the clearing house between the yen area, the dollar area and the EUA area. The latter might well go far beyond the Community and include for instance many of the ACP countries related to Sterling or the French Franc.

8. I personally believe all this would strengthen the dollar. To the extent that the EUA became an alternative reserve instrument it would take pressure off the dollar. And the larger the number of countries participating in the scheme, the less volatile would US/European exchange rate movements be. In any case, there is absolutely nothing anti-American in the scheme although it might lead to the EC becoming a little bit more inward-looking than in the past.

9. During the start-up period the scheme would have to be very flexible. Intra-Community exchange rates would have to retain a fair amount of flexibility. I would like to remind you of the fact that over time there have been quite a few revaluations and devaluations within the snake but it all happened

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in an orderly manner and without great fuss. Overall the scheme would lead to much greater stability. It would reduce the role of the DM as a future reserve currency and possible establish the EUA as an alternative reserve instrument.

18. These then are some of the ideas which I wanted to share with you. They are very private ideas. They are not a German proposal. They do not even represent a proposal, formal or informal. They are intended to go beyond 1978. They can be enlarged upon. They can be reduced. The details need very thorough examination indeed.It will take at least a month or two of study before you can make up your mind on whether it is worthwhile to pursue these ideas further.