

THE EUROPEAN MONETARY SYSTEM

OTHER BOOKS BY PETER COFFEY

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Macmillan, London, 1971.

“The Social Economy of France”, Macmillan, London, 1973.

“The World Monetary Crisis”, Macmillan, London and St. Martin’s
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“The Common Market and its International Economic Policies”, The
Hague, 1982.

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The European Monetary System – Past, Present and Future

by

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The author is Head of the Economics Section of the Europa Instituut, University of Amsterdam. He has published many works on European and international economic and monetary problems.

Mr.Coffey, who speaks seven languages, has lectured in most countries of the EEC, as well as in many other parts of the world.

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PREFACE

The European Monetary System (EMS) is perhaps the only success story of the Common Market since the First Enlargement. Its success, particularly where the commercial use of the ECU is concerned, has taken most experts by surprise. So much so, that when the author tried to recommend to his students a suitable and substantial work of study and/or reference about the experience of the EMS and its possible future evolution --- no book could be found. Thus, the author set out to write the present work.

The author's aim is not to give a historical account of the EMS. Rather, the intention is to place the experience in a major historical context wherein the System is seen an important transitional phase on the road to the implementation of a full economic and monetary union (EMU).

When examining the earlier plans for an EMU which saw the light of day between 1969 and 1970 (already so long ago!) clear reasons emerge why the original six founder Member States of the EEC should have found it logical to embark upon the road to an EMU - "provided the political will to do so existed". Thus, they had become highly integrated and were conducting half their trade with each other. Then, there was the desire to integrate still further ---- eventually leading (perhaps) to a political union. The existence of the Common Agricultural Policy (CAP) required stable (preferably fixed) exchange rates ---- an EMU would ensure just such a monetary stability. Last, but not least, the Community had become the world's most important commercial and trading bloc, holding enormous reserves of gold and hard currencies. It was therefore reasonable that the EEC should have a "common international monetary personality". The most concrete way of affirming such a personality would be to create a common currency.

Thus, many plans - representing the two main schools of economic and monetary thought (the "Economists" and the "Monetarists") - appeared, culminating in the compromise (second and definitive) Werner Plan. The main technical aspect of this plan was the so-called "Snake in the Tunnel", later becoming the simple "Snake Arrangement". This experiment, which lasted between 1972 and 1979, ended as a Deutsche-Mark Zone. It

cannot be described as having been a great success.

Already, however, in 1978, Chancellor Schmidt of West Germany and President Giscard d'Estaing of France, alarmed at American inaction in the monetary field and desirous of giving some momentum to further integration among Common Market countries, proposed a European Monetary System.

As is explained in this work, the EMS, which came into being in 1979, differs quite considerably from its predecessor. There are quite clear obligations imposed on the participants and they are under equally well defined constraints regarding intervention in the exchange markets and taking economic and monetary policy measures. On the other hand, it is much more flexible than the "Snake Arrangement". Exchange-rate adjustments (with one exception) have been swift, discrete and appropriate. The provision of credits for countries facing balance-of-payments problems is generous. Margins of fluctuations vis-à-vis the ECU have been "individualised" for participating Member States. But, then the ECU is the kingpin of the System, and, to the author, this is what the future of the EMS is really all about.

Although this work does not include a section devoted to theory, theoretical considerations have, at all times, been actively present in the author's mind ¹⁾. In the case of the European Monetary System (EMS), the author nevertheless considers, that, for the first time in many decades, the fundamental theory consideration, i.e. the question of public policy choice, to have been solved. Thus, all the participating countries in the EMS - plus the United Kingdom but not Greece (neither country being a member of the system) - have opted for the Magnifico²⁾ definition of an optimum currency area (OCA) - i.e. "a similar propensity to inflate". This would appear to be a logical choice since the EMS is a de-facto monetary union, and, although in the short run a "portfolio approach" ³⁾ may be adopted by countries, in the medium - to long term, inflation rates must converge or something in the system (usually exchange rates) must give way. In contrast, where a full economic and monetary union (EMU) is concerned, current definitions of OCA's may not be valid --- indeed --- an OCA may not necessarily be an EMU!

To the author, then, the present economic target consensus among all

but one of the EEC Member States is the correct one as far as the EMS is concerned. At the same time, the author considers the present system to be a transitional phase on the road to a full EMU. Furthermore, in advance of further moves towards greater economic and monetary integration, certain areas should receive particular attention. These areas are specific technical considerations, the integration of capital markets and banking systems and the future "real" European Monetary Fund. Also, present national attitudes to the role of the ECU and the future Fund deserve special consideration. Therefore, in this work, the author, in contrast with a number of his colleagues, has devoted a major part of his studies to these specific questions.

After five years of activity and in strong contrast with its predecessor, the "Snake" Arrangement, the EMS may be said to have been a success. Naturally, most of the system's protagonists would have wished to have seen a greater degree of integration materialise. Yet, not even the most ardent supporters of the EMS could have foreseen the ever increasing commercial use of the ECU. Furthermore, the author believes that the ECU's growing utilisation and success will force the Common Market to accept more integration and to create a "real" Fund.

Thus, this work is an advance study of areas where the author considers action will, by the force of events, have to be taken. The big question left unanswered in this book is when this action will be undertaken. Perhaps when the next edition of this work is published, this question will have been - at least partly - answered.

Amsterdam, June, 1984.

Notes:

1. A comprehensive examination of these theories may be found in P.Coffey, "Europe and Money", MacMillan, London, 1977.
2. See: G.Magnifico, "European Monetary Unification", MacMillan, London, 1973.
3. To the author, the "portfolio" approach means the willingness of institutes, banks and governments to hold the government paper of a country or countries.

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Special Note

Greece has not yet completed her transitional phase for her complete integration into the EEC (according to the rules of the Treaty of Rome). Equally, the Greek currency (the Drachma) will not be included in the ECU before the end of 1985. Also, Greece is not a member of the EMS. Therefore, the author did not include Greece in this study.