From the Werner Report to the euro

Some remarks by Hans Tietmeyer at the meeting on 29 November 2010, organised by the Institute for Monetary and Financial Stability in Frankfurt am Main

I

More than 40 years ago, the **Werner Group** presented the first joint report concerning a plan for the stage-by-stage implementation of economic and monetary union in Europe, thus initiating the first concrete negotiations.

It is true that there had been earlier initiatives by the Commission as well as by individual associations and groups with the aim of strengthening monetary policy cooperation in the EEC – especially after the severe intra-European exchange rate tensions partly owing to the weakness of the US dollar and the pound sterling in the 1960s. But despite growing tensions, by the end of the 1960s, the Community had not progressed beyond non-binding consultations on current issues by the Monetary Committee and the Committee of Central Bank Governors as well as occasional talks in the Council of Ministers.

However, on 1 and 2 December 1969, a policy decision was then taken in **the Hague** by the Heads of State or Government confirming their willingness to deepen and to enlarge the Community with a view to creating an economic and monetary union. On 6 March 1970 the Council of Ministers instructed the chairmen of the expert committees as well as a representative of the Commission to set up a working party, presided over by the Luxembourg Prime Minister, **Pierre Werner**, to write a report analysing the different existing proposals with a view to elaborating a common plan for the gradual establishment of economic and monetary union of the Community.

The **Werner Group** – in which I collaborated actively as the deputy of its German member, Johann Schoellhorn, state secretary of the West German Ministry of Economics – then presented its **final report on** 8 October 1970. The common positions found in the Werner Group itself were, however, not accepted at the time, especially by the French side (despite the approval of Bernard Clappier and J.M. Bloch-Laine).

The formal Council resolution of 22 March 1971 was therefore initially confined, for the most part, to general statements but largely left aside decisions on the key issues.

One year later (on 10 April 1972), the central banks of the six member states agreed to narrow the margins of fluctuation among the currencies of the Community, creating a system known as the "**European currency snake**". Shortly afterwards, they also introduced several support systems, and the Ecofin Council also decided to establish a European Monetary Cooperation Fund (EMCF), an institution which was <u>not</u> proposed in the official report of the Werner Group.

In the end, however, this cooperation among the member states and their national central banks, which focused on exchange rate policy, was in substance no more than voluntary and played only a limited role.

In particular, the varying responses of the national policies to the oil price explosion in the **1970s** led to increasingly severe exchange rate tensions within the now already enlarged EEC. In some cases, this was accompanied by individual member states leaving and re-entering or not participating in the exchange-rate policy cooperation.

At the end of the 1978, the French President,Valéry Giscard d'Estaing, and the German Federal Chancellor, Helmut Schmidt, initiated a new beginning with agreement on the so-called **European Monetary System (EMS)**, but this made no further progress initially. The creation of a European Currency Unit or **ECU** was an attempt to establish the nucleus of a European currency. Yet the ECU was unable to play a role over and above being a common unit of account and a divergence indicator summarising the differing outcomes of national market movements.

It was only during the 1980s that a greater convergence of national stability policies gradually began to prevail, and – following the submission of the Delors Report in 1989 – there was also a growing willingness to accept **supranational** central bank competences. This opened the way for a Community solution with a supranational currency.

This then resulted in the Maastricht Treaty and the ECB solution, which took up a number of key points already contained in the Werner Report. Thus it may be said that the Werner Report itself helped to lay key foundations for the euro and the institutional arrangements that are now in place, even though there are still substantial divergences.

II

From the outset, there were two divergent ways of thinking within the Werner Group itself. In the public debate, the proponents of these two concepts were labelled as "**economists**" or "**monetarists**".

While the Dutch, German and, to some extent, the Italian representatives argued in the Werner Group for the basic principle of **prior economic policy harmonisation** with the aim of achieving at first far-reaching convergence in competitiveness and preferred economic policy targets, the members from France, Belgium and Luxembourg pressed for an **early monetary policy convergence**, such as narrower fluctuation margins, the establishment of a reserve and foreign exchange equalisation fund and restricted discretion for autonomous changes in parity.

Given the major structural differences among the member states and diverging policy priorities, the **economists** saw the risks of rapid monetary policy convergence as being too great. In their opinion, monetary integration without prior harmonisation of economic policy would rest on shaky foundations and harbour the constant risk of monetary union breaking apart.

By contrast, the main aim of the **monetaristic** concept was to create pressure for structural adjustment and economic policy harmonisation through early monetary policy binding.

However, the argument about the best approach also concealed deeper **differences in political aims**.

In particular, the French side were still very much influenced at that time by the Gaullist tradition and therefore largely rejected further supranational decision-making structures. While, in the monetary sphere, they advocated fixed exchange rates as far as possible, and monetary policy reinsurance by means of joint stand-by arrangements or a community fund; in the field of economic and fiscal policy they were in favour of maintaining maximum national sovereignty – at least in formal terms.

This contrasted with the view taken at the time by us in the Federal Republic of Germany, but also by the representatives of the Netherlands, that the degree of harmonisation in economic and fiscal policies needed for a lasting monetary union could only be achieved and safeguarded by additional communitisation of decision-making and that, to do this, the Community's decision-making structures would have to be extended **generally** towards becoming a more political union. The dominant opinion at that time in the German economic and political debate was that an enduring supranational currency union could only exist if it were part of a general and permanently viable **political union**. **At that time**, such far-reaching political integration in the Community of Six was something that German policymakers were **still** largely prepared to undertake following the catastrophe of the Third Reich.

These varying fundamental positions also influenced discussions within the Werner Group. While the interim report of 20 May 1970 still contained clearly differing positions, the group largely presented joint proposals and statements in its <u>final</u> report. The most important results can be summarised as follows.

1) Economic and monetary union is defined as an objective that can be achieved in the course of ten years provided that the political will exists. Monetary union is defined as a currency area requiring "internally, the complete and irreversible convertibility of currencies, the elimination of margins of fluctuation in rates of exchange, the irrevocable setting of parity relations and the total liberalisation of movements of capital." Even though the changeover to a single currency then no longer makes any difference economically, the Werner Group believes there are strong political and psychological reasons for changing over to a single currency with common monetary symbols.

2) The Werner Group believes, however, that a currency union is not possible without the creation of an economic union. Economic union necessitates to a large-scale a transfer of economic policy powers from the national level to the level of the Community. The report states that "Economic and monetary union thus acts as a catalyst for the development of political union which in the long run it will be unable to do without."

3) The crucial principle governing the relationship between economic and monetary policy which the Werner Report sets out as a compromise is the **postulate of parallelism**. Parallel development is to apply in at least three ways to the construction of monetary union.
   - Parallel development of advances in economic policy convergence and monetary policy convergence
   - Parallel development of monetary policy convergence and the transfer of economic policymaking powers
   - Parallel development of the construction of Community powers and functional Community institutions.

4) At the Community level, the Werner Group regards at least two Community institutions as essential in the long term: a joint and independent central banking system modelled on the Federal Reserve System in the United States and an economic policy decision-making body.

5) The construction of economic and monetary union should be a three-stage process. The first stage should be focused, above all, on a better coordination of economic policy that could be supported – depending on the progress made in convergence – by a certain narrowing of the exchange rate fluctuation margins and possibly also by a European Monetary Cooperation Fund.

6) At the end of the first three-year stage, an assessment of the results achieved in the first stage then has to be made. And before the end of the first stage, pursuant to Article 236 of the EEC Treaty, a conference of representatives of the Governments of Member States should be called in order to prepare the amendments to be made to Treaty for the second and third stages.

III

As I have already mentioned, these findings and proposals of the Werner Group met with only partial approval in the Council of Ministers in 1971. French policymakers, in particular, were unable to consent to the basic political outlines of a political union. Nor were they at this time able to accept the proposal for new supranational institutions. The proposals were also too demanding for most of the other member states at this time.

Added to this was the fact that, in 1972, the accession of three new member states (UK, Denmark and Ireland) turned the EEC into the **Community of Nine**. In the 1970s, this enlargement, together with the collapse of the Bretton Woods system and growing internal divergences in economic and monetary policies owing to the oil price explosion, caused ambitions with regard to economic and monetary union in Europe to be lowered for a time.

It was only from the mid-1980s onwards, after the shortcomings of the less ambitious approach with the European Monetary System (EMS) initiated in 1978 by Giscard d'Estaing and Helmut Schmidt had become obvious and more common ground had been created between France and Germany in terms of stability policy following the difficult realignment of 1983, that thoughts began to turn again to stronger monetary policy cooperation in Europe.

The initiative came first from the new President of the European Commission, **Jacques Delors**. His 1985 proposal for the Single European Act took up the subject of economic and monetary union again, and the new treaty included a new procedure for paving the way to a economic and monetary union.

Soon afterwards, there were proposals especially from those associated with the French finance minister, **Édouard Balladur**, not only to make the EMS more symmetrical but also to work to strengthen the economic and monetary policy cooperation in Europe, especially between France and Germany. (A Franco-German Economic and Financial Council was established in 1987.)

Franco-German cooperation and the ongoing development of European integration were additionally galvanised by the increasingly close relationship and growing trust between President François Mitterand and Federal Chancellor Helmut Kohl.

At the European Summit in Hanover in June 1988, a **new expert committee** was appointed, this time chaired by Jacques Delors, with all the central bank governors of the now 12 EC member states as well as three independent experts. The mandate of the Delors Group was, however, more specific than that given to the Werner Group nearly 20 years earlier.

The report presented by the **Delors Group** in spring 1989 largely reaffirmed the findings of the Werner Report but was primarily confined to monetary policy issues in the narrower sense and stressed, in particular, the necessity of creating a "European Central Banking System" that would be independent and committed to the objective of maintaining price stability.

The need to coordinate national economic policies was also emphasised, but no institutional proposals were made for this. Binding rules were proposed only for safeguarding **budgetary discipline**.

Furthermore, the Delors Report assumed that not all EC countries would participate in monetary union from the outset but that the door should be left open for them to join later on.

A comparison of the two reports shows, in particular, the following differences in strategy.

1) While the Werner Report still assumed that all member states would take part in monetary union, the Delors Report leaves this question open – mainly owing to British pressure. This also means that the question of monetary union being politically identical with the EU is left open and that a more ambitious agreement on working towards political union is no longer a realistic goal.

2) The supranational ECB is to be politically independent and oriented to the objective of price stability, but responsibility for internal economic and fiscal policies should ultimately remain clearly at the national level of the member states.

3) “Binding rules” with effective limits for budget deficits are to be set only for the budgetary policy of the member states, and direct access to central bank loans is to be prohibited.

Following in-depth negotiations, these basic elements were set down in the 1992 Maastricht Treaty together with an additional stipulation. Only member countries which have fulfilled the following convergence criteria are to admitted to the final stage of monetary union.

- Achievement of a high degree of price stability.
- Sustainable public finances
- Compliance with the normal ERM fluctuation margins
- An acceptable level of long-term interest rates.

Furthermore, the member states’ budget performance is to be examined regularly in terms of compliance with the rules laid down in the Treaty and the additional Stability and Growth Pact.

IV

Following the launch of Stage Three of EMU in 1999, monetary union – with the euro as the single currency and monetary management by the supranational and politically independent ECB – has undoubtedly proved an overall success over the past decade despite some problems and difficulties.

Particularly in the wake of the global financial crisis and the detection of long-concealed massive fiscal deficits in some member states, as well as external imbalances that have grown sharply within the union, it must be added, however, that we have entered a new and difficult critical period, notably last year, and the end of this phase is not yet in sight.

In particular, the following shortcomings have become obvious:

- The interpretation of the selection criteria was in some cases too generous.
- The permanent fiscal control is not efficient enough.
- There is not sufficient pressure for convergence and competitiveness among the participating countries.

As it is currently constructed, the European Commission in my view cannot adequately fulfil its surveillance function.

I regard it as imperative to have **politically neutral surveillance** and strengthened **public pressure** through timely disclosure of the data.

Without regular critical examination and assessment of the member states' actual policy by the financial markets, the lasting convergence that is needed is unlikely to be achieved.