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## **A learning process?**

### **European monetary cooperation before the EMS negotiations, 1974-1977**

“Since the Werner-Plan a dozen years ago and since the days of the snake, since the founding of the EMS in particular, different bodies and groups have done enormous preparatory work for further monetary cooperation. This work resembles a hidden treasure: all the papers are written by monetary experts and for the use of monetary experts; they therefore hardly ever have reached the attention of the leaders or heads of state or government; in most cases they have not even been given full attention and full reading by finance ministers.”

Helmut Schmidt, 30 November 1984<sup>1</sup>

## **Introduction**

This paper analyses the EEC monetary discussions before the EMS negotiations, and the relationship of this to the wider process of European monetary integration, from a historical perspective. It will start in 1974, with the virtually simultaneous coming to power of Helmut Schmidt, Valéry Giscard d'Estaing and Harold Wilson, but also the (unofficial) abandonment of the implementation of the Werner Plan. It will go until 1977, that is to say before the revival of the EMU debate following Jenkins' initiative. It will first briefly sketch the main elements raised by two important proposals put forward over these four years. It will then seek to underline how some of the ideas contained in these failed attempts at improving European monetary cooperation re-emerged during the EMS negotiations, and, in more general terms, how they relate to wider issues of European monetary integration.

### **1. European monetary discussions, 1974-1977**

The period going from 1974 until 1977 saw a profusion of technically interesting projects but economically and/or politically ill-timed. Although most of the ideas which they suggested were therefore not accepted, they did hint at some significant features which would resurface on the occasion of the EMS negotiations. This section will briefly present two of the most important proposals put forward during this period, namely the Fourcade memorandum and the Duisenberg proposal.

#### *The Fourcade memorandum (September 1974)*

On 16 September 1974, Jean-Pierre Fourcade, the French Minister of Economics and Finance, presented his memorandum for *une relance monétaire européenne* before the Council of Ministers of the EEC.<sup>2</sup> He set out four proposals, among which, most importantly,

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<sup>1</sup> Archives historiques de la Banque de France, 1489200205/288, Text of an planned intervention by Helmut Schmidt at a conference of the European League for Economic Cooperation on 30 November 1984

<sup>2</sup> This paper exploits a wide selection of recently declassified primary sources. Research for this paper includes archival material from the European Commission, the Council of Ministers, the Émile Noël papers, various French archives (Giscard d'Estaing papers, SGCI, Ministère des Affaires Étrangères, Ministère des Finances, Banque de France), German archives (Helmut-Schmidt-Archiv, Auswärtiges Amt, Bundesarchiv Koblenz, Bundesbank Archiv) and British archives (The National Archives, The Bank of England Archive). For the text

the creation of a new European unit of account (EUA), and an adaptation of the intra-Community exchange rate system.

Firstly, he proposed the creation of a new European unit of account (EUA) which could be defined as the weighted average value of a “basket” composed of different European currencies. Secondly, he suggested reforming the Snake so that the reference rates and fluctuation margins would be defined in relation to the new EUA, instead of with the maximum differential between two currencies. This was meant to render the system more symmetrical.

The memorandum was then discussed at various levels, of course in the Council of Ministers of the EEC itself, but also in the EEC Monetary Committee and in the Committee of Central Bank Governors. By the end of the year, in early December 1974, Fourcade himself observed that the French text had not received the support of any country.<sup>3</sup> He resubmitted most of his proposals in an *aide-mémoire* to the Council of Ministers in May 1975.<sup>4</sup> With the exception of the creation of a new European unit of account and the testing of a common policy vis-à-vis the dollar, this new initiative suffered the same fate as the first one.

### *The Duisenberg proposals (July 1976)*

In July 1976, the then Dutch Economics and Finance Minister Wim Duisenberg proposed the creation of “target zones” for exchange rates.<sup>5</sup> This was meant to be the trigger for consultation and for coordination of economic policies: “Target zones would oblige a country to direct its economic, and in particular its monetary policies, to preventing a movement of its exchange rate below the target zone. (...) My proposal is intended mainly to strengthen the element of policy-coordination in the Community.”<sup>6</sup> There was therefore no formal obligation to intervene, but instead a strong element of economic discipline.

The basic aim of these proposals – namely to bring back EEC member states into a single broad exchange rate system, thus putting an end to the then division between the Snake currencies (essentially a deutschemark zone) and the independently floating currencies – was also that of Fourcade in 1974 and 1975. However, this time these proposals came from a Snake member (this was not the case of France in 1974) and from a country faring rather less badly than other EEC member states (this was also not the case of France two years before). By contrast to the French proposals therefore, the Dutch suggestions could not be seen from the start as a way to dissimulate the wrongdoings of its own domestic economic policy. Yet the Duisenberg proposals suffered, *mutatis mutandis*, the same fate. They particularly suffered

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of the Fourcade memorandum, see Archives Diplomatiques (AD), Direction des Affaires économiques et financières (DAEF), 971bis, Communication du président du Conseil des Communautés sur la relance monétaire européenne. See also de Saint-Périer, Amaury, "La France et la sauvegarde du système communautaire de change de 1974 à 1977", in Dumoulin, Michel, Schirmann, Sylvain et Bussière, Éric (eds.), *Milieus économiques et intégration européenne au XXe siècle. La crise des années 1970. De la conférence de La Haye à la veille de la relance des années 1980* (Bruxelles: P.I.E. Peter Lang, 2006), pp. 51-58.

<sup>3</sup> Archives Nationales (AN), 5AG3/908, Note pour le Président du Ministre de l'Économie et des Finances, objet: préparation du sommet européen, 02/12/74. This was confirmed by Dutet in similar terms five days later, see AN, 5AG3/908, Note pour le Président de JP Dutet, Objet: réunion des Chefs de gouvernements de la CEE: questions économiques et financières, 07/12/74.

<sup>4</sup> Centre des Archives Économiques et Financières (CAEF), Fonds Trésor, B0050484, Aide-mémoire sur le fonctionnement du mécanisme européen de rétrécissement des marges, 20/05/75.

<sup>5</sup> Council of Ministers Archives (CMA), Intermediate 9716.

<sup>6</sup> Archiv der sozialen Demokratie (AdsD), Helmut-Schmidt-Archiv (HSA), 1/HSAA006603, Letter of Duisenberg to Schmidt, 7 December 1976.

a strong opposition from the German government, which feared that such a system would lead to a weakening of the snake arrangement.<sup>7</sup>

## **2. The relationship of these discussions to the big process of European monetary integration**

Numerous connections could be found between the ideas raised during the EEC monetary discussions of 1974-1977 and the wider process of European monetary integration. This section will focus on three of them. First it will analyse the ideas which resurfaced on the occasion of the EMS negotiations. Second it will come back to the wider issue of the “economist vs. monetarist” debate, of which the Fourcade and Duisenberg plans were good examples. Third it will examine how both of these plans illustrated another important issue of European monetary integration, namely the debate about the method to reach it (qualitative leap forward or incremental process).

### *The connections between the EMS negotiations and the Fourcade/Duisenberg plans*

In technical terms, a number of ideas contained in both proposals resurfaced during the EMS negotiations, and were partially recycled in the new European exchange rate system.

Firstly, one of the most important features of the EMS negotiations was the discussion about the place of the unit of account at the centre of the new system. It is noticeable that this suggestion was already at the centre of the Fourcade memorandum a few years earlier. The Fourcade memorandum had indeed suggested that the snake should be built around the new European unit of account, which was actually one of the two competing options during the EMS negotiations. Admittedly, the option chosen was not the Fourcade one, but instead the parity grid (in which rates were established between all the members, bilaterally).

Secondly, the EMS created a ‘divergence indicator’ meaning that if a currency diverged from the ECU central rate by 75% of the maximum authorised divergence, measures in order to prevent further exchange rate tensions ought to be taken. This was, at least in spirit, very close to what Duisenberg had suggested a couple of years earlier. The creation of target zones was meant to provide an objective indicator as a trigger for intervention.

### *The centrality of the “economists vs. monetarists” debate*

The Fourcade memorandum, and, to a lesser extent, the Duisenberg proposals, underlined the longstanding dichotomy between the “monetarist” and “economist” approaches to European monetary integration.

The difficulty in reaching an agreement on which strategy – “economist” or “monetarist” – the European Community should use in order to proceed to European and Monetary Union (EMU) was at the core of the discussions on this subject in the 1960s and 1970s (and arguably up until the creation of the euro). Each option was a logical and coherent method, but each aroused the utter opposition of up to three other member states. The main difficulty was therefore to try to overcome this impasse, not only at the European level but also, as in the French in case, at the domestic level.<sup>8</sup>

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<sup>7</sup> See for instance Schmidt’s reply to Duisenberg in AdsD, HSA, 1/HSAA006603, Letter of Schmidt to Duisenberg, 20 January 1977.

<sup>8</sup> Emmanuel Mourlon-Druol, “Economist or Monetarist? The difficult creation of an internal French consensus about European monetary integration (1974-1976)”, in Michele Affinitio, Guia Migani and Christian Wenkel (eds), *The Two Europes*, (Brussels: Peter Lang, to be published in 2009).

The “economist” approach stated that the convergence in the economic situation of the member states comes before monetary union. Economic strategies and performance have to be harmonised and to coincide before Europe could proceed to monetary union. Economic convergence meant to lower inflation rates, to synchronise economic cycles, to eliminate excessive debts and deficits. The “economists” could agree that the creation of a common currency was a significant and desirable objective, but they totally rejected the idea that it could be *the* dynamic element of the integration process. Helmut Schmidt’s declaration in September 1974 regarding possible progress in European monetary integration typically was “economist”: “the time has not yet come to return to the pursuit of economic and monetary union: Extreme disequilibria in current balances of payments might cause the Community to drift farther apart rather than grow closer together. (...) Under these circumstances, the only way to success is to continue an European stability programme with a view to harmonizing national economic policies.”<sup>9</sup>

The “monetarist” strategy was the antithesis of the “economist” one. It claimed that monetary constraints could induce economic convergence. This is, of course, not to be confused with Milton Friedman’s brand of monetarism. Monetarists consider that the fixing of exchange rates would in itself cause macroeconomic convergence, and that as a consequence monetary unification would proceed sooner or later. Indeed, the need to maintain predetermined exchange rates would exert pressure on member states to make their own domestic economic policies compatible with the policies at Community level.<sup>10</sup> It would also have the advantage of focusing on the most salient, symbolic, and politically attractive aspect of EMU, namely the creation of a common currency.

As such, the Fourcade plan could therefore clearly be situated in the “monetarist” tradition. Not only did it stress the importance of the unit of account, but also it suggested a reform of the exchange rate system at a time when the European economies were starkly diverging. It therefore (unofficially) assumed that a monetary arrangement could improve economic convergence – hence a “monetarist” statement. The Duisenberg proposal was, by contrast, slightly more ambiguous. Indeed, it contained two legs: a “monetarist” one (the target zones) and an “economist” one (economic coordination).

Interestingly, the terms of the EMU equation for the French government changed in August 1976, with the coming to power of Raymond Barre. Although EMU remained the ultimate aim of the French government, the most immediate question was no longer to rejoin the Snake, but rather to concentrate on how to create stable and lasting conditions for an economic convergence (particularly with Germany), leading in the end to an improvement of monetary cooperation.<sup>11</sup> The hierarchy of priorities had thus been reversed. As far as European monetary cooperation was concerned, this burgeoning Franco-German consensus could allow thought of a possible change of fortunes.

### *Achieving EMU through a qualitative leap forward or an incremental process?*

The Fourcade memorandum and the Duisenberg proposals underlined another significant feature of European monetary integration, namely the issue of how EMU should be achieved: thanks to a qualitative leap forward or through an incremental process?

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<sup>9</sup> Historical Archives of the European Community (HAEC), Fonds Émile Noël, EN 599, Ausführungen des Bundeskanzlers in Paris am 14. September 1974.

<sup>10</sup> Kruse, D.C., *Monetary Integration in Western Europe. EMU, EMS and beyond*, (London: Butterworths, 1980), p.63.

<sup>11</sup> The National Archives (TNA), FCO 30/3626, Note of Bayne to Fretwell, Franco/German relations – Economic aspects, 30 June 1977.

During the mid- to late 1970s, initiatives in the monetary field progressively started to adopt a different approach than the Werner one. The Werner report had proposed a full-fledged plan to reach EMU. The idea was to reach EMU through three stages in ten years. Given the current economic, monetary and political difficulties, the option to adopt a more cautious approach began to appear wiser in the mid- to late 1970s. The choice was then between an incremental process or a qualitative leap forward. Or, put it differently, should European governments seek a small and limited improvement of the monetary situation by building up on existing mechanisms – namely the Snake – or by devising new comprehensive and sophisticated plans aimed at reaching EMU – a Werner-style approach? A wide consensus favoured the first option. The Bundesbank, the French Treasury, but also heads of governments progressively realised that full-fledged schemes designed at EMU were, in the present circumstances, doomed to end in a failure.<sup>12</sup> The *Report on European Union*, a report written by the Belgian Prime Minister Léo Tindemans, released in January 1976, confirmed this new thinking.<sup>13</sup> It thus recommended that the Snake be the starting point of further monetary integration. This was also the main rationale behind the Fourcade memorandum and the Duisenberg proposal in 1976.<sup>14</sup>

## Conclusions

By analysing two failed attempts at improving European monetary cooperation in the 1970s, this paper has tried to show that the story of the quest for monetary stability in Europe during this period was the one of a slow, tortuous but continuous learning process leading to the rethinking of the motivations, the aims, the scope and actually the content of European monetary cooperation.

The 1970s had started off with an ambitious objective: Economic and Monetary Union by 1980.<sup>15</sup> And by 1980 indeed, the EEC ended up with a mere improved version of the exchange rate system which was in operation for about ten years. Admittedly, it had a number of interesting improvements, a fancy European Currency Unit (ECU), able to let some to dream that it could form the embryo a future common currency, and a new Exchange Rate Mechanism (ERM) but in the end the overall EMS was a complex system quite difficult to understand, at the very least for the general public. And it was, most importantly, very far from the ambitious hopes expressed at the start of the decade.

What this paper has tried to suggest is that although the 1970s were a time of stagnation, crisis, and even frustration, particularly in the EEC,<sup>16</sup> and although a number of initiatives in the monetary field actually failed, it was also a period when a new economic and monetary consensus began to emerge, and which would considerably influence later development in the EEC. This was the case, for example, with the Fourcade and Duisenberg proposals. And even more importantly, the overall intellectual framework which permitted the

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<sup>12</sup> See Historisches Archiv der deutschen Bundesbank, B330/DRS142, Protokoll der 413. Sitzung des Zentralkomitees der Deutschen Bundesbank, 22/05/74. See also Service des Archives Économiques et Financières, B0050484, Note de Jacques de Larosière pour le Ministre, objet: éventuelle relance de l'Europe monétaire, 09/74.

<sup>13</sup> Bulletin of the European Communities, Supplement 1/76, European Union, Report by Mr Leo Tindemans, Prime Minister of Belgium, to the European Council.

<sup>14</sup> By contrast, the academic debate over monetary unification was much more in favour of a qualitative leap forward. This was particularly the case with the approaches encouraging the creation of a parallel currency (cf. All Saints' Day Manifesto, Optica Reports).

<sup>15</sup> This objective was proclaimed at The Hague Summit in 1969.

<sup>16</sup> Stefan Collignon describes the period beginning in 1973 as "The New Dark Age", see Stefan Collignon, *Monetary Stability in Europe*, (London: Routledge, 2002), p.16.

creation of the EMS – namely a new economic and monetary consensus,<sup>17</sup> the political will to search for a *European* solution, and the institutional innovation of the European Council created in 1974<sup>18</sup> – all began to emerge in the mid-1970s. Although the achievements of European monetary cooperation in 1979 were far from what had been hoped at the beginning of the 1970s, the decade had thus not been wasted for the process of European monetary integration.

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<sup>17</sup> See Kathleen McNamara, *The Currency of Ideas. Monetary Politics in the European Union*, (Ithaca: Cornell University Press, 1998).

<sup>18</sup> See Emmanuel Mourlon-Druol, “The Creation of the European Council at the December 1974 Paris Summit”, *Cold War History*, to be published in 2010, see also Emmanuel Mourlon-Druol, “The victory of the intergovernmental method? The emergence of the European Council in the EEC’s institutional set-up, 1974-1977”, paper presented at the International Conference, “The Road Europe Traveled Along. The Evolution of the EEC/EU Institutions and Policies”, Università degli Studi di Siena, 23-24 May 2008 (to be published in 2009 by Peter Lang).