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Manifesto for European Monetary Union

We, the undersigned, concerned at the lack of progress towards the goal of European monetary union to which the governments of the member countries of the European Community have repeatedly commited themselves, and at the harmful consequences of the inflation which we are experiencing, present this manifesto to the public in the belief that our proposal offers the best way of achieving a monetary system which will be not only European-wide in scope but stable as well.

This manifesto, then, is a statement of purpose based on what we consider to be sound economic analysis and at the same time in accord with the political aspirations of our time. Our emphasis on the use of market forces stems from our conviction that it is difficult to bring about a monetary union by official edict or by the establishment of grandiose institutions, no matter how well intentioned. On the contrary, we are convinced that it is for the people themselves to decide whether they want monetary union or not and that the only satisfactory way they can be given the opportunity to do so is by the introduction of a parallel stable money, as we explain below, which they may accept or reject as they wish. We believe they will accept it but we believe equally that they must accept it freely.

LESSONS FROM EXPERIENCE

Proposals for monetary integration appeared in the Werner report which set full economic and monetary union as a target to be achieved in three stages over a period of 10 years. The recommendations of the report were adopted as a goal of the European Community in March, 1971. Monetary union was identified with (1) total and irreversible convertibility of currencies; (2) elimination of margins of fluctuation in exchange rates; (3) irrevocable fixing of parities; (4) elimination of restrictions on capital movements; and (5) co-ordination of aggregate demand policies.

As in most endeavours which try to alter radically the course of events, the Werner report suffered from an excess of idealism. It overestimated the

This chapter and parts of the subsequent paper by Theo Peeters et al. appeared in The Economist, London dated November 1, 1975 (All Saints' Day).
willingness of governments to depart from national decision-making because it underestimated the costs associated with a fixed setting of ultimate targets and the policy strategy necessary to meet such targets. We are aware that governments have different priorities with respect to the goals of high employment and inflation and that they have fixed over the years to trade the achievement of one goal against the other. To the extent that wide differences of opinion remain about the scope and even the existence of such a trade-off, we must conclude that a common policy of the member countries is not feasible. Fixed rates of exchange necessarily imply grosso modo a common rate of inflation for participating countries. Therefore, the premature implementation of a rigid exchange rate regime, in the absence of monetary policy coordination, is bound to lead to balance of payments crises; in turn, these crises will either destroy the union or bring about a general misallocation of resources, of which unemployment will be the most visible and politically sensitive aspect.

The Werner approach concentrated political attention on exchange rate unification. It provided, therefore, intellectual justification for the 'snake' arrangement, instituted by the Community in March 1972. The snake scheme is essentially tantamount to the formation of a cartel where each member retains the right of opting out of the system. The opting-out provisions were necessary because of the failure to implement a system of quotas based on credible money supply targets. It is hardly surprising that it did not stand up fully against some of the strains it had to face.

A major weakness of the earlier approach based on co-ordinated decision-making is its non-automatic nature and its reliance on political discretion. Monetary unification, if it is to succeed at all, must be brought about by a gradual process. From a political point of view, it is necessary to proceed gradually so that nationalist feelings are not provoked by sudden losses of what are perceived to be national powers. The earlier approach, although gradual, was discretionary: the co-ordination of economic, monetary and exchange rate policies was based on an infinite series of painful compromises and concessions. It maximised political friction for minimal economic results. From an economic angle the case for gradualism and automaticity is the case for market processes.

The lesson we draw from the foregoing is that an approach to monetary unification which is based on co-ordination of policies will fail because it involves the locking of exchange rates without monetary reform. The approach we advocate is radically different in that it achieves monetary unification through monetary reform based on the free interplay of market forces.

THE CASE FOR A SINGLE STABLE MONEY

Money has a comparative advantage in transmitting information and in reducing uncertainty. The introduction of money in a barter economy frees resources which were previously absorbed by economic agents in finding

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Appropriate exchange rates between goods. The case for a monetary union is similar to the case for a monetary rather than a barter system. But the single money, which will eventually replace separate national currencies, has to possess purchasing power stability.

That a single stable money is better than multiple currencies (even if they are stable) as a medium of exchange is obvious from the fact that socially unproductive transactions between currencies are entirely eliminated. In its role as a store of value, a single currency with stable purchasing power would serve the community better than the existing arrangement of many currencies. Most importantly, it would eliminate exchange risks which are generated primarily by uncertainty as to how much money each central bank will supply in relation to the demand for this money. We believe it inappropriate to suggest that these risks may be eliminated by forward operations. The forward markets, beyond three months, are simply not that well developed and, even if they were, the resources devoted to them could be entirely freed by a single currency.

The aspect of multiple currencies which is probably most costly to society is its impairment of the efficiency of money as a unit of account or standard of value, since there is no common standard of value in a multiple-currency-flexible-exchange-rate system.

The objection that a single money is not necessary and that a fixed exchange rate between multiple currencies would perform equally well is only partly correct. It is true that currency transaction costs are reduced, but that is all. The more important disadvantages of multiple monies, the creation of uncertainty and the impairment of the efficiency of money as a unit of account, still remain. Experience with fixed exchange rates has been one of long stretches of little exchange rate flexibility interspersed by large jumps in parities. Uncertainty about parity changes has never been eliminated. Fixed exchange rates are inferior in this respect to flexible rates, and, in turn, flexible rates are inferior to a single stable-valued monetary system.

COPING WITH IMBALANCE

The main argument against monetary union is that it would be likely to result in an unwanted combination of unemployment and inflation in some or all members of the union. This argument derives from the negative relationship which is thought to prevail between unemployment and inflation. The studies undertaken in the 1950s and 1960s, which showed that this kind of relationship seemed to hold, have now been corrected. More recent studies indicate that, in the long run, employment is independent of the rate of inflation. We urge governments to accept the conclusion which follows from this, namely, that monetary policy, whilst influencing the rate of inflation, cannot reduce what has come to be called the 'natural' rate of employment, i.e. the rate of unemployment which is determined by labour market conditions, taxation policy, and a variety of structural and institutional factors. Accordingly, any
Monetary reform to fight inflation will become more urgent the longer the current inflationary situation lasts. The launching of a new common European money, the Europa, offers a unique opportunity of carrying out this monetary reform while at the same time setting the pace for monetary integration. The most radical approach would be to replace the existing national currencies
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baskets used to calculate the national consumer price indices. The weights ought to reflect the relative share of each country in community GNP, intra-community trade, etc. The Europa itself is expressed in terms of a (weighted) basket of national monies.

Europas will be exchanged against the basket of national monies at a variable exchange rate that would be implied by the maintenance of a constant purchasing power of the Europa. As a practical guideline, the exchange rates between national monies and the Europa would be adjusted according to a crawling peg formula. The timing of the crawl would depend on that of the publication of the relevant price indices. This would amount to adjusting the exchange rate between the Europa and each of the national monies by a weighted average of inflation rates of consumer prices expressed in national monies.

When the Europa has ultimately replaced national monies, its supply should be controlled according to a monetary rule that would continue to guarantee its purchasing power stability.

THE EUROPA SOVEREIGNTY

Initially, we envisage that the central banks would issue the Europa against national monies only. In that way it would not add to the total community stock of money. Only at a later stage would it be issued through rediscounting of bills and other loans to the banking system, through open market operations or through financing of community expenditures. To the extent that the issue of a stable Europa will raise the demand for real money balances, such additions to the money stock can be absorbed without a simultaneous fall in the demand for national monies.

Will monetary policy be more conducive to long-run stability in the monetary union than in the existing arrangement? The answer to this important question depends on the type of institution or institutions which will eventually replace national monetary authorities. Whatever the details of the arrangement, it would be wise to keep in mind one guiding principle: we must give the monetary authorities the same independence from political control and the same responsibility to the rule of law we have accorded the judicial system. It follows that the new institution or institutions should be removed from the jurisdiction of treasuries, and monetary authorities should be appointed or elected for long periods of time, if not for life. The purpose of these two features is to assure a longer time horizon than can be found in other branches of government.

SUMMARY

We recapitulate the principal propositions emerging from the document.

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1. It is difficult to envisage a monetary union created by official edicts and legalistic structures. It must evolve in the market place.
2. The benefits of a monetary union are qualitatively similar to the benefits accruing to a society as it moves from a barter to a monetary arrangement.
3. The case for a monetary union is not a case for fixed exchange rates in a world of many monies. It is rather a case for the replacement of all national monies with one common unit of account, medium of exchange and store of value.
4. The single money (Europa) which will replace national monies must have stability of purchasing power.
5. Our vision of monetary union differs from other visions in that we do not emphasise labour and capital mobility but rely on structural policies to correct possible regional imbalances.
6. There are no unemployment costs in monetary unification in the long run. The abdication of the national monopoly to print money has consequences only for the national rate of inflation, not for the long-run rate of unemployment.
7. The cost of monetary unification is transitional and results from the temporary loss of employment as the country adjusts its inflation rate to the union inflation rate.
8. The adoption of the Europa presupposes the political will to harmonise inflation rates among countries. It also presupposes that national governments will be willing to replace the inflation tax with explicit taxation. We thus call for a full-fledged monetary reform.
9. In the period when the Europa and national monies will coexist, the quantity of Europas will be solely determined by the desires of those who want to hold it. Conversions between Europas and national monies will occur at variable ratios.
10. To preserve the benefits of the monetary reform, i.e., the benefits which derive from a stable-valued money, monetary authorities should be given the same independence from political power and the same responsibilities to the rule of law we have accorded the judicial system.

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