Capital mobility, achievements and ambitions. The long road to the European Monetary System, 1958-1979

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Introduction

Background

The economic crisis started in 2007-2008 and has resulted in turmoil on international financial markets and a sharp drop in economic activity.[1] Eurozone member countries were faced with problems regarding sovereign debt and competitiveness. Excessive borrowing, unhealthy public finances and a lack of structural reforms proved to be a serious challenge, since persistent divergences among different countries were revealed.[2] In May 2010 the European Financial Stability Facility was created. This entity was created to preserve financial stability by making sure that EU-countries in difficulty are provided with financial assistance.[3] Since then the European Commission has proposed nearly 30 sets of rules to improve regulation and supervision of the financial sector.[4] The Eurozone debt crisis has thus led to institutional reform. The banking supervision and mechanisms involved was an important proposition among other initiatives of the Commission to prevent a future banking crisis from happening. The EU has created new supervisory authorities at an European level and has established capital requirements for banks. Furthermore the EU has closed non-viable banks and introduced guarantees for deposits. The financial sector has been restructured.[5]

With the creation of these mechanisms the European integration process has deepened in order to solve economic problems. In debating these developments a striking resemblance can be seen with those that were present during the creation of the European Monetary System (EMS). Many issues that were discussed then are central in current debates, such as the question whether resources should be transferred from richer to poorer countries, and the question whether a German-like monetary policy, with its focus on an independent central bank and austerity measures, should be applied.[6] The creation of fiscal and financial mechanisms also led to a revival of old traditional debates on European integration. For instance, Cooper and Vilpišauskas have

[1] S.S. Nello, *The European Union: Economics, Politics and History* (Berkshire 2012) p. 246.
[2] R. Vilpišauskas, 'Eurozone Crisis and European Integration: Functional Spill-over, Political Spillback?', *Journal of European Integration* (2013, 35:3), p. 362.
[3] E. Mourlon-Druol, E., *The Euro Crisis. A historical perspective* (2011), p. 7.
[4] European Commission, *MEMO/13/679 10/07/2013*: 'A comprehensive EU response to the financial crisis: a strong financial framework for Europe and a banking union for the eurozone'.
[5] European Commission, MEMO/13/679.
[6] Mourlon-Druol, *The Euro Crisis*, p. 1, 9.

stipulated neofunctionalist arguments when discussing further going Eurozone integration.[7]

Predecessor of the EU was the European Economic Community (EEC). The EEC was created in 1957 and was mostly about the establishment of a common market. Economic integration and especially free trade of products was the key project of European integration since the 1960s. The customs union was implemented between 1959 and 1967 and the first step was reduction of intra-Community tariffs by 10% while quotas were increased by 20% in January 1959.[8] The removal of internal rules and barriers to trade was a liberalising sort of integration. In the early period of European integration this economic policy was top priority. Within this common market the EEC focused on the establishment of four freedoms, namely the free movement of goods, capital, services and people. As a result in the European Economic Community (EEC) internal rules and barriers to trade were removed.[9] At the core of European integration in the 1960s were three policies: agricultural trade liberalisation, industrial trade liberalisation and the removal of regulatory trade barriers.[10] The common market was thus top priority. Monetary fluctuation was potentially harmful for it could cause trade distortions between EEC countries. If for instance a country would have a strong, high-valued currency, this currency must be revaluated. A country with a weak currency, on the other hand, should have to devalue. This creates a competitive advantage, for products will be priced less because of the devalued currency. This would be harmful for exporters of other countries. Their governments might respond with the erection of trade barriers. Such a development would pose a serious threat for the internal customs union.[11]

Despite various disputes and political crises in the 1960s, notably because of the Common Agricultural Policy (CAP), the customs union did quite well. This changed in the late 1960s when the monetary system of Bretton Woods started to collapse. In 1969 the French were forced to devalue the franc. A few months later the Germans revaluated the mark. Monetary fluctuations endangered the most important achievements of the

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[7] I. Cooper, 'The euro crisis as the revenge of neo-functionalism,' (2011) via http://euobserver.com/opinion/113682; R. Vilpišauskas, 'Eurozone Crisis and European Integration: Functional Spillover, Political Spillback?', *Journal of European Integration,* Volume 35, Issue 3 (2013).
[8] D. Dinan, *Europe Recast. A history of European Union* (Hampshire 2004) p. 89.
[9] Dinan, *Europe Recast,* p. 89.
[10] A. Moravcsik, *The Choice for Europe. Social Purpose & State Power from Messina to Maastricht* (Ithaca/New York 1998), p. 37.
[11] Mourlon-Druol, *The Euro Crisis,* p. 2.

EEC and action was required.[12] Monetary cooperation became therefore an important issue in the 1970s.[13]

Problem formulation

It is clear from the previous paragraphs that there is indeed a relation between problems on the internal market and monetary cooperation. The question therefore is if this link is of decisive importance, and if so, to what extent. Can monetary integration in the 1970s be explained by the internal market? This is in line with the academic debate on the causes of the institution-building at a European level and the processes involved. Ernst Haas and Leon Lindberg are, among others, important participants in this debate. They try to explain the moments of European institution making with a so-called theory of neofunctionalism.[14] Neofunctionalism will be explained further in chapter 1 but it is important to mention here that the concept of spill-over is at the core of this theory. The spill-over concept argues that rise of intra-EEC trade and capital mobility will reinforce support for monetary integration or EMU (Economic Monetary Union). More intra-EEC trade will heighten the importance of exchange rate fluctuations for stakeholders. Policy autonomy will be more under pressure as exchange rate stability is required.[15] If it will be this economic integration that works as a spill-over for financial integration, the neofunctionalist argument will be strengthened. Moravcsik is a scholar who is strongly opposed to this view. According to Moravcsik, this view is performed by Kathleen McNamara[16] and Barry Eichengreen and Jeffrey Frieden.[17, 18] Eichengreen and Frieden state indeed that support for EMU will be shaped by rising intra-EU trade.[19] Moravcsik criticises the central element of the neofunctionalist theory, the spill-over effect.

> "[Monetary integration] was not a straightforward result of direct 'spill-over' from rising trade interdependence. (…) Almost no evidence supports the view that (…) the maintenance of the customs union – often cited by the Commission and occasionally by national leaders – significantly influenced national monetary preferences. Such arguments are inconsistent with

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[12] D. Marsh, *The Euro. The battle for the new global currency* (New Haven 2011) p. 44-47.
[13] E. Mourlon-Druol, *A Europe made of money. The emergence of the European Monetary Systeem* (Ithaca 2012) p. 22-23.
[14] Nello, *The European Union*, p. 7.
[15] B. Eichengreen and J. Frieden, 'The Political Economy of European Monetary Unification: an Analytical Introduction', *Economics and Politics* (1993) p. 18-19.
[16] K. R. McNamara, *The Currency of Ideas: Monetary Politics in the European Union* (Ithaca, 1998).
[17] Eichengreen and Frieden, 'The Political Economy'.
[18] Moravcsik, *The Choice for Europe*, p. 286.
[19] Eichengreen and Frieden, 'The Political Economy', p. 18-19.

> patterns of support for policies. Rising trade independence alone cannot explain why business in weak-currency countries should favour pegged exchange rates. At most the stability of the common market was invoked as a justification for policies pursued for other reasons."[20]

There are differing explanations for monetary integration in the 1960s-1970s. Some scholars focus on geopolitical motivations of national leaders. Other scholars focus on economic ideas. Moravcsik argues instead that national economic interests were the main motivation behind monetary integration in this period. In the next chapter this will be explained more detailed but I want already make it clear that there are differing views on the causes of monetary integration in the 1960s-1970s. Therefore in this thesis it is examined to what extent the customs union and higher levels of economic coherence have attributed to the emergence of the Snake and the EMS in the 1970s. To see whether Moravcsik is right, and to explain monetary integration in the 1970s and in recent years, the main question in this thesis is therefore:

> What was the motivation behind the search for monetary stability and integration in the 1960s-1970s in the European Economic Community?

Defining the main question

What does monetary integration in this period signify? Moravcsik points at two main decisions: the creation of the Snake (the European Exchange Rate Agreement) in 1973 and the creation of the European Monetary System in 1979.[21] I will go along with this interpretation and when I speak of monetary integration I mean mainly the creation of the Snake and EMS and discussions in which these systems were involved. Can it be said that preserving the common market is the main argument for developing the Snake and the EMS? And does further going monetary integration serve a geo-political goal, or is it rather an economic one?

Regarding the customs union, this can be described as an area in which member states have removed all barriers regarding internal trade, and erected a common external policy towards third countries. In this thesis 'common market' and 'customs union' are used randomly, although they are not entirely the same. In a common market it is precisely free movement of goods, services, capital and people that is added to the concept of a customs union. In the 1960s-1970s the EEC was also said to be a common

[20] Moravcsik, *The Choice for Europe*, p. 286.
[21] Ibidem, p. 238.

market, but that was not entirely true. Except for certain sectors – mainly agricultural and also increasingly industrial products – the EEC was more like a customs union.[22] The customs union had to serve as an irrevocable step towards the erection of a common market.[23] In different (primary) sources both terms are used randomly and therefore this is also done in this thesis. When speaking of the 'customs union' and 'common market', it can simply be defined as a customs union in which focus lies on free movement of goods (agricultural and industrial).

By trying to explain monetary cooperation in the 1960s and 1970s (in other words, the creation of the Snake and the EMS), the neofunctionalist theory is useful, for it gives some clear indicators that can be examined. The definition of spill-over is as follows:

> "'spill-over' refers to a situation in which a given action, related to a specific goal, creates a situation in which the original goal can be assured only by taking further actions, which in turn create a further condition and a need for more action, and so forth."[24]

Two main elements are in this definition very important that can serve as indicator. First, a certain action in a certain area brings problems to another area that are really disturbing. There has to be a relation between the two sectors and they have to be intertwined in order for actions or problems in the first sector to influence the situation in the other sector as well. Second, these problems must be solved with more cooperation in the other area. If there are other alternative actions possible, than the relation is not strong enough to speak about a real spill-over effect. For the topic of this thesis this means the following. These two elements must be taken into account when researching relations between economic and monetary problems on the internal market and the euro and, as a result of that, integration in the field of monetary issues. Therefore it is first necessary to examine if there is indeed a relation between the internal market on the one hand, and the monetary field on the other. Do problems in the internal market really cause a need for monetary integration? I have argued before that this is indeed the case. Therefore the second question is very important. Namely, if this relation indeed exists, can it be said that this is of decisive importance or can it be that there are other causes as well? A third element could be added as well. In the spill-

[22] Nello, *The European Union*, p. 5-7.
[23] M. Segers, *Reis naar het continent. Nederland en de Europese integratie, 1950 tot heden* (Amsterdam 2013) p. 118.
[24] L.N. Lindberg, *The political dynamics of European economic integration* (Stanford 1963) p. 123.

over definition above emphasis lies also on an original, specific goal. I will also look for this overarching goal and see if this is a geo-political or economic goal. This creates the following research questions:

- *How was the customs union related to different developments regarding monetary integration in the 1960s/1970s? Did problems regarding the customs union cause monetary integration? What other causes were there?*
- *Can it be said that there was an overarching goal, and is this rather economic or geo-political?*

Operationalisation

For answering these questions secondary literature is very important, especially because a lot has been written about the situation in the 1970s by various experts. In the next chapter it will be explained what they argue about reasons for monetary integration in the 1970s. Primary literature is also used in order to answer the research question appropriately. It is highly relevant what main actors (Commission, Parliament, Council) say about reasons for monetary integration. Therefore archive documents recounting what heads of states actually said to each other, for example in meetings of the European Council, are conducted in this thesis. Of key importance is the transcript of a meeting between the German Chancellor Schmidt and members of the Bundesbank Council, in which Schmidt explains his reasons for supporting the European Monetary System. Not all this kind of documents are that well available. Therefore reports like the Barre Report, the Werner Plan and documents of the Commission – notably of Commission President Jenkins - will also be analysed.

The focus lies mainly on France and Germany, for these countries were the main actors with regard to this topic.[25] Also Schmidt himself declared that he saw France and Germany as the two core countries of the EEC and that EMS was needed because "France and Germany (…) can only form the backbone of the Community in the long term when they do not belong to two different monetary areas".[26]

The thesis is structured as follows. In the first chapter I will outline several traditional theories on European integration that are relevant. Then the history of

[25] P. Ludlow, *The Making of the European Monetary System* (London 1982) p. 37.
[26] Bundesbank Council meeting with Chancellor Schmidt, 'Transcript of meeting of the Bundesbank Council, 30 Nov 1978', Margaret Thatcher Archive, (http://www.margaretthatcher.org/document/111554).

discussions about EMU can be divided into different principal phases, according to several authors.[27] In the first phase, between 1958 and 1969, ideas about monetary integration did emerge but the EEC was mainly busy with implementing the customs union and CAP. The second phase, early 1970s, was between December 1969 (the summit in The Hague) and 1974 with the creation of the Snake. In this period serious efforts were made regarding monetary integration. In these years the system of Bretton Woods got into trouble and the Barre Report and Werner Report were written. The third period, the late 1970s, stretches from 1974 until 1979. In Spring 1974 Giscard came to power in France, Schmidt in Germany and Wilson in Britain. Also was in 1974 the Werner Plan abandoned. This period ends with the in force entering of EMS in March 1979.[28] I will end with a final conclusion.

The relevance of this thesis lies mainly in the fact that it analyses decisions taken in the 1960s and 1970s with regard to monetary integration, and assesses this in light of traditional theoretical debates on European integration. As said before, there is already a lot of existing literature in which broad lines are very well outlined. Nevertheless does the thesis add several elements to existing insights. First it is made clear what the actual role of the common market was within monetary integration in this period. In existing literature this role is not that often mentioned and I have specifically looked for it in original reports, policy documents, speeches and so on. Most existing secondary literature also emphasises mainly the emerging and content of monetary integration. In this thesis perspective lies mainly on motivation behind monetary integration in the 1960s and 1970s. Some other authors do also focus on underlying motives, but they focus mainly on one single element, for instance Moravcsik. In this thesis different kind of complementary motivations are present. Furthermore the thesis can attribute to the academic debate in which the neofunctionalist approach and the liberal intergovernmental theory of Moravcsik are opposite, for the spill-over effect is important in this thesis.

In recent years we have seen attempts to create fiscal and financial integration as well. These attempts have everything to do with the single currency, that derives from EMS and monetary integration in the 1970s. The way in which the thesis tries to examine it can attribute to gain insight in this very complicated topic.

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[27] Mourlon-Druol, *A Europe made of money*, p. 22; L. Tsoukalis, *The Politics and Economics of European Monetary Integration* (Oxford 1977) p. 12-15; Ludlow, *The Making*, p. 2-3.
[28] Mourlon-Druol, *A Europe made of money*, p. 14, 22.

Chapter 1. Background and Debates

When it comes to supranational cooperation the question emerges why states are willing to cooperate and thereby loose some of their powers. This first chapter is about the traditional debate about the process, motives and causes of European integration. Several key ideas are recalled which are needed to understand monetary cooperation.

First I will discuss the earlier mentioned neofunctionalist theory. In this theory economic and political integration are strongly related. Ernst Haas, one of the most important neofunctionalist theorists, has also emphasized the role of supranational institutions. Integration in specific economic sectors would create a demand for political integration shaped by supranational institutions.[29] However, as will be seen, the theory of neofunctionalism is not unchallenged at all. Both the application and scope of the theory as well as its theoretical consistency has been criticised.[30] Therefore the neofunctional theory and how it applies to monetary integration will be helpful for the central topic of this thesis. Than Andrew Moravcsik's liberal intergovernmentalist theory will be discussed. As we will see this theory is very different from neofunctionalism. Moravcsik emphasises economic interests of countries and argues that they are the primary reason governments are willing to go on with monetary integration instead of geo-funtional reasons. The customs union can indeed be used as an economic reason, which is in line with Moravcsik's theory, but as we will see the customs union is largely used as a geo-functional reason (see for instance German Chancellor Schmidt's statements at his secret meeting with the Bundesbank in Chapter 4). Moravcsik himself also declares so.[31] Lastly some remarks are made on the different theoretical views that try to explain monetary integration in the 1960s-1970s.

Neofunctionalist theory

The neofunctionalist approach was developed by Ernst Haas (1958), Leon Lindberg (1963) and Philip Schmitter (1970). They were preceded by the famous Jean Monnet, who was an important neofunctionalist. For Jean Monnet the theory was not only a

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[29] R. Wolfrum and C. Philipp, et al, *United Nations: Law, Policies and Practice* (München 1995) p. 765.
[30] A. Niemann, *Explaining decisions in the European Union* (Cambridge 2006) p. 20-23; A. van der Vleuten (red.), *De bestuurlijke kaart van de Europese Unie: Instellingen, besluitvorming en beleid* (Bussum 2007), p. 228-229.
[31] Moravcsik, The Choice for Europe, p. 286.

conceptual framework, but also a strategy. It was his expectation that integration in one sector would lead to integration in other sectors as well. This was how a closer union could be achieved.[32]

The theory developed by Haas, Lindberg and Schmitter was a result of the establishment of the European Coal and Steel Community (ECSC) and the European Economic Community (EEC). Haas argued in 1958 that cooperation within the ECSC has led to new lines of communication, as well as to closer relations between political parties and commercial organisations. According to Haas, this process started with the ECSC and led to the integration of other political and economic sectors, which in this case resulted in the EEC.[33] This was achieved in a process of spill-over. The idea of spill-over was the key element of the neofunctionalist approach. This was further defined by Lindberg in 1963:

> " 'spill-over' refers to a situation in which a given action, related to a specific goal, creates a situation in which the original goal can be assured only by taking further actions, which in turn create a further condition and a need for more action, and so forth."[34]

Spill-over therefore means that cooperation in one sector will generate impetus for cooperation in other sectors. This neofunctionalist idea of change and development has two important elements. First, the neofunctionalist theory aims at explaining European integration. Second, the theory also describes the driving force behind integration as an inherent logic result of economic integration. This means that integration in one sector causes a certain pressure on other sectors to integrate as well. This is because some sectors between industrial economies are so intertwined and dependent of each other that they can hardly be isolated. Integration of one sector leads inevitably to problems in other sectors, which can only be solved by further integration in those sectors.[35] For example integration of defence sector will require democratic control, and is therefore a spill-over for political integration.[36]

The neofunctionalist approach was very influential in the 1960s, but later on the theory had to endure heavy criticism. The critics focused mainly on the predictions of the theory, such as the expectation of Haas that a political union would arise after a transition period of twelve years after the Treaty of Rome. Later on this was also denied

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[32] Niemann, *Explaining decisions*, p. 12-13.
[33] E. B. Haas, 'The Challenge of Regionalism', *International Organisation*, Vol. 12, No. 4 (1958) p. 450.
[34] Lindberg, *The political dynamics,* p. 123.
[35] Niemann, *Explaining decisions*, p. 12-18.
[36] Nello, *The European Union*, 7.

by neofunctionalist scholars themselves, including Haas. But other aspects were also due to criticism. First the great theoretical pretences of the theory were criticised. It was rightfully said that there could not be a theory that explained all elements of European integration. Second, the spill-over-effect assumed a growing economy and economic welfare. This was indeed the case in the 1950s and 1960s, but in the 1970s the economic situation became problematic. Third, criticisers argued that the neofunctionalist approach focused too much on actors and ignored (internal) political structures in which these actors had to operate. Fourth, neofunctionalism underestimated nationalist elements of states and the importance of sovereignty for governments. Fifth, the theory failed to take external elements into account, for example developments in the Cold War and the General Agreements on Tariffs and Trade (GATT) or World Trade Organisation (WTO), which have influenced the integration in Europe.[37] Due to these comments the theory was revised by A. Niemann, among others. The revised neofunctionalist theory still claims that integration is a process in with different developments are connected rather than that they are single developments, but has acknowledged that this process is influenced by multiple and diversified actors and structures. Preferences of these actors can change during the process. Furthermore, the 'new' theory of neofunctionalism also underlines the importance of institutions which are created. These institutions can evolve in different directions and are hard to be controlled by those who created them. In the reformulation of the theory, the central idea that integration is driven by the interdependent links between different sectors remained unimpaired. However, the idea of neofunctionalism as a comprehensive theory disappeared. Neofunctionalism can now be seen as a 'partial theory'. It only applies to a part of European integration that is about explaining integration and output of the process. Assumptions of the spill-over-effect are also moderated. It is no longer claimed that the spill-over-effect generates an ever ongoing process, while on the other hand opposing forces such as sovereignty and nationalism are taking into account.[38] The adaptation of the theory also has consequences for how the spill-over-effect can be seen. Spill-over does not only have a functional element, as it was described by Lindberg. This means that the original goal has to be achieved by further integration, which generates more integration, and so on. The spill-over-effect can also have exogenous elements. If this is the case, the effect will

[37] Niemann, *Explaining decisions*, p. 20-23.
[38] Ibidem, p. 24-28.

be influenced by factors outside the scope of European integration. The European integration is thus part of a global system. There is also a political element. National politicians sometimes realise that problems and interests of their country cannot be handled sufficiently on the national level. Therefore they focus on the European project, and by doing so these politicians can stimulate European integration. The spill-over can also have cultivated elements. Institutions can evolve in different ways and might become an engine for future integration. Supranational institutions are often positive about integration, for they benefit from it and gain in power.[39] An important element of neofunctionalist theory is also its emphasis on specific goals. These goals could be achieved by various forms of spill-over: increasing economic interdependence between European states and continuous demand for greater institutionalisation would increasingly undermine the sovereign state, and work towards a supranational Europe.[40]

A newer version of neofunctionalism is supranationalism. Supranationalism differs from neofunctionalism because it focuses on integration of several policy areas, instead of the process of integration in general. Important supranationalist scholars are Wayne Sandholtz and Alexander Stone Sweet.[41]

Liberal intergovernmentalism

A second important approach was the intergovernmentalist theory by scholars as Stanley Hoffman. This theory focused more on the central role of national states. Among other things Hoffman has argued that integration has not at all caused an undermining of the sovereign states. The process of integration only took place because of the willingness of state actors. Key actors in institutional integration are therefore the member states.[42] The approach of Andrew Moravcsik builds upon theories of intergovernmental scholars as Hoffman and Milward. Moravcsik tries to explain the process of European integration by adding to the intergovernmental theory a liberal theory that addresses the formation of national interests. When it comes to national

[39] Niemann, *Explaining decisions in the European Union*, p. 29-46; Van der Vleuten, *De bestuurlijke kaart,* p. 226-228.
[40] M. Eilstrup-Sangiovanni (et al.), *Debates on European Integration. A Reader* (Basingstoke/New York 2006) p. 90.
[41] Van der Vleuten, *De bestuurlijke kaart*, p. 229.
[42] S. Hoffman, 'Obstinate or Obselete? France, European Union and the Fate of the Nation-State', in: S. Hoffman, *The European Sisyphus; Essays on Europe, 1964-1994* (Boulder/San Francisco 1995) p. 71.

interests Moravcsik argues that states cannot be seen as unitary actors.[43] In his article 'Preferences and Power in the European Community', 1993, Andrew Moravcsik calls his theory 'institutional intergovernmentalist' and he argues that this theory is more able to explain European integration than the neofunctionalist approach, which he calls 'supranational institutionalism'.[44] In 1998 in his book 'The Choice for Europe' he tries to underpin his theory by using five case studies. In these cases Moravcsik argues that the national interest is not decided by geo-political factors, which in the neofunctionalist approach is about safety reasons. Moravcsik calls this 'security externalities'.[45] In this approach, economic factors can be important for the European integration, but only in that sense that economic factors can influence the safety of the member states. Therefore economic factors are subordinate to geopolitical factors. Moravcsik does not agree with this. He claims that the basis for the formulation of national interests of states are domestic economic factors instead of geo-political factors. These interests are developed in the interaction between states and civil society groups. These groups differ from each other in their identity, interests, and influence on domestic policy and articulate preferences. In order to remain powerful governments have to be supported by domestic voters, parties, and so on. Therefore governments have an incentive to transmit the views of important society groups into domestic political institutions and practices. National interests and goals are becoming clear during this process, and it is in this way determined what the position of states will be in international negotiations.[46] These domestic factors are primarily economic or commercial, and, according to Moravcsik, they are the primary reason why states in Europe chose to integrate. He states that European integration must be explained as rational choices which respond to economic interests of powerful domestic groups. The position of a state in the international system and roles of international institutions are subsequently contributing to the final decisions taken.[47] In the 1970s monetary integration (creation of the 'Snake' and emergence of the European Monetary System) was the most significant development in the 1970s in the EEC. Both systems were about stabilising exchange rates. According to Moravcsik, decisions taken with regard to creating both

[43] A. Moravcsik, 'Preferences and Power in the European Community. A liberal intergovernmentalist approach', *Journal of Common Market Studies*, Vol. 31 No. 4 (1993) p. 483.
[44] Moravcsik, 'Preferences and Power', p. 473-524.
[45] Moravcsik, *The Choice for Europe*, p. 27-35.
[46] Moravcsik, 'Preference and Power, p. 483.
[47] Moravcsik, *The Choice for Europe*, p. 18.

systems must be explained by economic interests of member states.[48]

In this debate Sandholt and Stone, two neofunctionalist scholars, acknowledge that liberal intergovernmentalism and neofunctionalism are opposites. They argue that, despite the abandonment of neo-functionalism by the 1980s, the neofunctionalist approach still offers a valuable theory when it comes to explaining European integration and institution building.[49] They are not convinced by the supremacy of the liberal intergovernmentalist theory for different reasons. They argue that if supranational institutions act in line with the interests of the member states, this is a confirmation of the theory that claims that European integration is subjected to the position of governments. But if, on the other hand, there is no adherence in the acts of the supranational institutions and the preferences of the governments, this can also confirm the theory. The theory therefore is not falsifiable. For this and other reasons they claim that the neofunctionalist theory has to be preferred over the liberal intergovernmentalist theory:

> "Neofunctionalism offers a causal explanation of the development of EU institutions and the expansion of their authority. Until a new theory can explain what it does better, it will remain the most theoretically viable and empirically productive general theory of European integration."[50]

In this thesis it will be seen of the neofunctional theory does indeed offer a causal explanation of monetary integration in the 1960s and 1970s, or, in other words, in developing the Snake and the European Monetary System.

Debating monetary integration in the 1960s-1970s

Earlier explained theories of neofunctionalism and liberal intergovernmentalism are clearly differing. The neofunctionalist theory underlines mainly a political goal, namely monetary integration as a means to obtain for instance political union or a supranational Europe.[51] Moravcsik does not agree with explanations of monetary integration in the 1960s-1970s that focus on geopolitical and ideological motivations of national leaders, the so-called high politics. In these geopolitical explanations for economic cooperation, economic policies and underlying high-political goals are linked. Economic integration is

[48] Moravcsik, *The Choice for Europe,* p. 238-239.
[49] A. Stone Sweet, W. Sandholtz, *Neofunctionalism and Supranational Governance* (2010) p. 2-3.
[50] Stone Sweet, Sandholtz, *Neofunctionalism*, p. 31-34.
[51] Eilstrup-Sangiovanni, *Debates on European Integration*, p. 90.

not an end in itself but merely a means to achieve political or military goals. With regard to the central topic of this thesis, monetary integration in the late 1960s and 1970s, in most geopolitical approaches is European integration seen a result of Willy Brandt's Ostpolitik and therefore his strengthened commitment to Western integration, as well as Georges Pompidou's aim to limit German power. Later in the 1970s Helmudt Schmidt and Valéry Giscard d'Estaing were mistrusting the United States' foreign policy and this is also seen as a main explanation for integration.[52] Schmidt needed the EMS to become less dependent of the United States, in economic as well as defence matters.[53] According to Moravcsik, this view is performed by Michele Charles Wyplosz and Jeffrey Sachs.[54] Wyplosz and Sachs argue in their article 'The Economic Consequences of President Mitterand' that membership of the EMS had high political importance for Valéry Giscard d'Estaing.[55] Other authors that focus on high politics as explanation are Michele Fratianni and Jürgen von Hagen[56] and Haig Simonian.[57] Economists Von Hagen and Fratianni argue that EMS is mainly explained by the aim to achieve political union through monetary integration.[58] In other words, the overarching goal of neofunctionalism is high-political and ideological motivated, in that sense that it aims for political union by way monetary integration, which demands by its nature fur such a further going integration.

Another explanation for monetary integration and creation of the EMS, according to Moravcsik, is domestic policies and economic ideologies.[59] Jonathan Story is among the scholars arguing for this. He claims that both Schmidt and Mitterand had strong domestic incentives to join in the monetary policy initiative. Both needed EMS to shore up their standing with other opposition parties.[60] Another scholar who argued for the influence of economic ideas and domestic incentives is Kathleen McNamara.[61] Rising trade independence and maintenance of the customs union is also an important

[52] Moravcsik*, The Choice for Europe*, p. 27, 238.
[53] Ibidem, p. 238-239.
[54] Ibidem.
[55] J. Sachs, C. Wyplosz (et al.), 'The Economic Consequences of President Mitterrand', *Economic Policy*, Vol. 1, No. 2 (1986) p. 295-296.
[56] M. Fratianni and J. von Hagen, *The European Monetary System and European Monetary Union* (Colorado 1992) .
[57] H. Simonian, 'France, Germany, and Europe,' *Journal of Common Market Studies*, Vol. 19 No. 3 (1981).
[58] Fratianni and Hagen, *The European Monetary System*, p. 16-19, 221.
[59] Moravcsik, *The Choice for Europe*, p. 238-239.
[60] J. Story, 'The Launching of the EMS: An Analysis of Change in Foreign Economic Policy', *Political Studies* (1988) p. 402.
[61] McNamara, *The Currency of Ideas*.

(geopolitical) explanation of monetary integration in the 1970s. This view is performed by Kathleen McNamara[62] and Barry Eichengreen and Jeffrey Frieden[63].[64] Eichengreen and Frieden state indeed that support for EMU will be shaped by rising intra-EU trade. They argue that monetary policy autonomy becomes more and more in conflict when countries become more financially integrated and are therefore in need of exchange rate stability. Furthermore, higher levels of intra-EU trade expands the ranks of firms and individuals who will benefit from reducing exchange-rate volatility. This will likely strengthen support for EMU.[65]

Moravcsik disagrees with these scholars. He argues that monetary integration in the 1960s and 1970s, the creation of the Snake and the EMS, was the result of interstate bargaining. In this process German interests won over the French.[66] He claims that national economic interests were the main motivations for monetary integration in this period. Countries, notably Germany, wanted to maintain their macroeconomic autonomy. This autonomy was undermined by both rising capital mobility and the decline of the Bretton Woods system. The need for stability exchange rates was triggered by these causes. Furthermore German governments wanted to dampen appreciation of the Deutsche Mark and French governments wanted to dampen currency volatility.[67] Moravcsik states that there is no evidence that proves that rising trade interdependence and maintenance of the customs union is the main trigger for monetary integration. Instead he argues that it is rising capital mobility and national economic problems that were caused by this capital mobility that was the main reason for monetary integration in the 1970s.[68] He claims that the German government's economic motivation was emanated by the existence of two opposed German groups. The first group, mainly exporters, favoured a fixed exchange rate system in which their competitiveness was assured, even if this would increase inflation risks. The second group consisted of domestic, no tradable firms, and the powerful Bundesbank. This group favoured a strong anti-inflation policy and cared less about competitiveness. The Bundesbank wanted to maintain autonomy about currency appreciation in order to

[62] McNamara, The Currency of Ideas.
[63] Eichengreen and Frieden, 'The Political Economy'.
[64] Moravcsik, *The Choice for Europe*, p. 286.
[65] Eichengreen and Frieden, 'The Political Economy', p. 18-19.
[66] Moravcsik, The Choice for Europe, p. 305.
[67] Ibidem, p. 238-239.
[68] Ibidem, p. 286.

respond to capital inflows. Because of this the German currency was constantly undervalued and strongly shored up by the Bundesbank if depreciation was needed. In times of currency volatility, however, goals of export competitiveness and low inflation could no longer both be maintained. In these cases Germany was pressured to either revalue the mark or inflate domestically. The German Chancellor Schmidt had thus a strong incentive for monetary integration. Coordination of currencies would prevent them from being vulnerable to currency volatility. In this view monetary integration is a means to protect national economic interests.

Moravcsik's view is not undisputed. Mourlon-Druol admitted in 2012 that the EMS was indeed largely intergovernmentally created. But he finds it problematic that various actors involved in the process did not act rationally based on national economic interests. For instance Giscard d'Estaing figured, both in 1975 and 1978, that political advantages of the EMS would outweigh financial and economic risks.[69] Lieshout, Segers and Van der Vleuten are critical of Moravcsik's methods and external consistency. They argue that a lot of Moravcsik's quotations and references are incorrect and that he misreads sources that support his claims.[70]

[69] Mourlon Druol, *A Europe made of money,* p. 273-274.
[70] R. S. Lieshout, M. L. L. Segers, J. M. van der Vleuten, 'De Gaulle, Moravcsik, and The Choice for Europe: Soft Sources, Weak Evidence', *Journal of Cold War Studies*, Volume 6, No. 4 (2004) p. 89-90.

Chapter 2. The 1960s (1958-1969)

This chapter is about monetary integration in the years between 1958 and 1969, before the The Hague Summit took place. For convenience I call this period 'the 1960s'. Consolidation of the common market was the central issue in these years. In this chapter focus lies mainly on monetary matters. Therefore first I start with information about the common market in the 1960s in which it seems already clear the need felt for monetary integration. Then I will make some remarks on the decline of the Bretton Woods system, the Barre Report and monetary instability at the end of this period. The chapter will end with a short conclusion.

Monetary integration in the 1960s

In 1958 the European Economic Community was established by the Treaties of Rome.[71] The broad objectives of the Treaty establishing the European Economic Community were laid down in Article 2:

> ''It shall be the aim of the Community, by establishing a Common Market and progressively approximating the economic policies of Member States, to promote throughout the Community a harmonious development of economic activities, a continuous and balanced expansion, an increased stability, an accelerated raising of the standard of living and closer relations between its Member States.''[72]

For creating a customs union for industrial and agricultural products removal of internal tariffs was required, harmonisation of external tariffs, and a common commercial policy for negotiating with third parties.[73] A common external tariff was erected for goods that were entering the Community. Therefore no member state would be in a position to impose a reduced external tariff and thereby gain a competitive advantage. It was this measure that was responsible for the Community being merely a customs union instead of a free trade area.[74] Between 1960 and 1969 agreement was reached regarding the Common Agricultural Policy, but little movement was seen in other economic policy

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[71] Nello, *The European Union*, p. 22.
[72] Treaty Establishing the European Economic Community (http://www.cvce.eu/content/publication/1999/1/1/cca6ba28-0bf3-4ce6-8a76-6b0b3252696e/publishable_en.pdf) (hereafter the EEC-treaty) article 2.
[73] Moravcsik, *The Choice for Europe*, p. 206.
[74] N. Nugent, *The government and politics of the European Union* (London 2010) p. 22-23.

areas, notably macroeconomic coordination.[75] The Treaty did mention coordination of economic policies, but did not address macroeconomic coordination and economic or monetary union directly.[76] The Spaak Committee had stated that economic activity would be restricted by currency fluctuations. However, imposition of freedom of capital movement, full convertibility and monetary union was rejected. The member states were not directly obliged to coordinate their macroeconomic policies, but a central authority was established for non-binding monetary and fiscal policy recommendations.[77] Important with regard to this subject is Article 107, which says: ''Each Member State shall treat its policy with regard to exchange rates as a matter of common interest.''[78] In the Treaty the common market and economic cooperation were thus closely linked to monetary cooperation, although this was implicit and did not oblige member state to regulate their exchange rates. There were some considerations involved: the international monetary system relied heavily on the dollar and monetary circumstances were quite well at that time.[79] At the Bretton Woods Conference in 1944 it was agreed that members would link their currencies to gold at a fixed exchange rate. The dollar had become the main reserve currency after the Second World War and was thereby very influential. International currencies were tied to both the dollar and gold. It was registered by the International Monetary Fund (IMF) that each country had a legal gold valuation for its currency. This was defined towards the dollar, the main reserve currency. The rates of these currencies kept maintained towards the dollar because of intervention of the Central Banks by using their main reserve currency, the dollar.[80] European exchange rates had to be held within fluctuation bands of plus or minus 25. The system of Bretton Woods created an atmosphere of stability for currencies, which attributed to European economic recovery after the war.[81] There was thus little need for a European monetary system.

In 1964 the Bundesbank stated that plans of the Commission for a monetary union had to be accompanied by a political union in which national sovereignty was

[75] Nugent, *The government and politics of the European Union*, p. 159.
[76] Nello, *The European Union*, p. 24-25.
[77] Moravcsik, *The Choice for Europe,* p. 149.
[78] Treaty Establishing the European Economic Community, art. 107.
[79] Nello, *The European Union*, p. 24-25.
[80] Marsh, *The Euro*, p. 35.
[81] Nello, *The European Union*, p. 24-26.

transferred to the European level.[82] Member states were were reluctant to give up autonomy of monetary and fiscal policies. There was little need to create a monetary system for the EEC-countries. The common market was in a 'favourable international economic climate.'[83] There was rapid economic growth and employment had very good levels. At the same time inflation was rising, but not towards dangerous levels. The member states of the EEC had a much better economic performance compared to the United States and the United Kingdom.[84] In the Marjolin Memorandum of 24 October 1962 the Commission called for the customs union to result in an economic union by the end of the 1960s in order to fix exchange rates between the currencies of its member states.[85] However, member states were having the opinion that the system of Bretton Woods ensured widespread exchange stability. Therefore they considered that intra-EEC exchange rate stability was secured without the need for new institutional measures. The Marjolin Memorandum did thus not result in any follow-up actions. Only a Committee of Governors of the central banks of the member states was established in 1964.[86] It was again the Bretton Woods system that was responsible for no further monetary integration in this period.

Decline of Bretton Woods and monetary instability

It is clear that there was little purpose for establishing monetary arrangements between the member states. But by the end of the 1960s the international situation had changed significantly. The Bretton Woods system showed signs of increasing tensity.[87] Early in the 1960s the unbalanced payments of the United States grew fast. Debts of the United States towards foreign central banks and other holders of dollars started to exceed the value of gold stock of the federal government. It was questioned whether American reserves were sufficient to maintain convertibility of the dollar to the fixed gold price.[88] As a result of the U.S. balance of payments deficit and in order to protest against U.S.

[82] D. Marsh, *Europe's Deadlock. How the Euro Crisis Could Be Solved – and Why It Won't Happen* (Hampshire 2013) p. 59-60.
[83] Nello, p. 24-26.
[84] Ibidem.
[85] H. K. Scheller, *The European Central Bank. History, role and functions* (European Central Bank, Frankfurt am Main, 2004), p. 17.
[86] Scheller, *The European Central Bank,* p. 17.
[87] Ibidem.
[88] Marsh, *The Euro*, p. 47.

macro-economic policies, France started in 1967 to convert its dollars into gold and eliminate the reserve currency status of the dollar and sterling.[89] The British tried to prevent the sterling from devaluation, but in 1967 they finally had to devalue the pound by 14,3%. This predicated sales of the dollar and a run towards gold. The position of the pound remained unstable as the sterling holders of other countries remained restive. In March 1968 problems of the sterling pound forced an end to the link of currencies with gold. Dollars were sold for gold at an undervalued price. This led to a cumulative €3,7 billion losses.[90]

From the late 1960s on productive investment had stagnated in France. Production costs increased, and this resulted in a competitive disadvantage for France. Devaluation was necessary. But earlier, from late 1950s until 1973, France achieved high export-led growth. This growth together with tight fiscal policy and use of devaluation insured economic growth while inflation was not a problem. When the dollar's position weakened in early 1960 the franc came also under pressure, but due to French trade surpluses the government was able to maintain stabilisation. Nevertheless, the dollar in decline did cost more and more problems for the franc in the lead-up to the collapse of the Bretton Woods system. At the same time the oil crisis, slower economic growth, the political crisis in which De Gaulle's referendum was rejected and the electoral Left opposition rose fast, altogether this meant a serious challenge. The franc was depressed against de mark as a result of capital floating towards Germany because of U.S. dollar depreciation. 1968-1969 capital movement thus caused huge pressure for the franc against the German mark.[91]

In 1969 the German industry had also become more and more competitive when demand for German products increased. As a result exchange rates between the German mark and other EEC currencies changed. Higher value of the German currency required other currencies to be worth less. The position of both the dollar and the franc was weakening in 1968-1969. Capital flowed therefore towards Germany, causing international pressure for a revaluation of the mark. Germany, however, did not revalue the mark as a result of strong position of German exporters, who were strongly opposed to revaluation.[92] This showed the interdependence of EEC-countries, for capital flows

[89] Dinan, *Europe Recast*, p. 117; Marsh, *The Euro*, p. 47-49.
[90] Marsh, *The Euro*, p. 52.
[91] Moravcsik, *The Choice for Europe*, p. 260-264.
[92] Moravcsik, *The Choice for Europe*, p. 248-249; Marsh, *The Euro*, p. 63-64.

revealed how imbalanced its economies really were. It also became clear that the Community was not able to handle this problems.[93] According to Scheller of the European Central Bank, greater price and cost divergences between member states 'threatened to disrupt the customs union and the common agricultural market, which had been functioning quite successfully up to then'.[94] Other authors state as well that the decline of the Bretton Woods system undermined domestic macroeconomic autonomy and was a main trigger for the need for stabilising exchange rates.[95]

DeGaulle refused to devalue the franc, but he was unable to force the Germans to revalue. In April 1969 DeGaulle had to resign. His successor Pompidou soon announced an 11% devaluation and proposed negotiation on monetary integration.[96] Shortly afterwards the government of Willy Brandt came into office.

Barre Report

In January 1968, when the dollar was under downward pressure, the Commission came with an initiative for more monetary integration. This resulted in the so-called Barre Report (1969). In this Report the Commission stated that monetary policies of the countries should be regulated towards a common position with regard to exchange rates.

> "In the view of the Commission, the establishment of Community machinery is justified by the fact that the Member States are linked together by a customs union and by common or co-ordinated economic policies: it is therefore reasonable that these States, considering their obligations to each other and the advances advocated in co-ordinating their economic policies, should make the necessary arrangements for granting each other mutual support within their association."[97]

The Commission thus strongly emphasized the link between economic coordinated policies and the customs union on the one hand and establishment of institutional machinery on the other. This meant, according to the Commission, that day-to-day fluctuations for currencies of the member states around the parities should be abolished, and adoption of identical ranges of fluctuation in respect of non-member countries was necessary. Furthermore the Commission argued for the establishing of a

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[93] Tsoukalis, *The Politics and Economics of European Monetary Integration*, p. 58-59.
[94] Scheller, *The European Central Bank*, p. 17.
[95] Dinan, *Europe Recast*, p. 117; Moravcsik, *The Choice for Europe*, p. 239.
[96] Marsh, *The Euro*, p. 53-55.
[97] Commission memorandum to the Council on the co-ordination of the economic policies and monetary cooperation within the Community (http://ec.europa.eu/economy_finance/emu_history/documentation/chapter2/19690212en015coordineconpoli.pdf), (herafter called Barre Report) p. 8.

mutual assistance machinery, like a multilateral network of mutual credit rights.[98] In this way countries could coordinate their policies concerning production and employment growth rates, prices, the current accounts and the equilibrium of the overall balance of payments. As a result of such a system countries that were having problems with balance of payments could also lend money more easily from other member states.[99]

It becomes clear in the Barre Report that the Commission was serious concerned about fluctuations of exchange rates of currencies of member countries. This was seen as a threat for the common market and trade relations in the Community.[100] The Barre Report stated that exports to other member states of the Community had risen from one third in 1957 to nearly half of total exports in 1968. Due to rapid expansion of intra-Community trade member states had become more interdependent, which makes them more vulnerable to currency- and business fluctuations in other member states. This situation raised problems for business activities and payments equilibriums. Economic policies of each member state could strongly influence the customs union. Incompatibility between countries would endanger the internal market and intra-Community trade.[101] Altogether the call for monetary integration in the Report is not necessarily a call for further integration in itself, but it can better be seen as a way to protect past achievements of the Community. This strengthens the neofunctionalist argument.

Conclusion

Monetary integration was already in the Treaties of Rome present and several attempts were made to stimulate monetary cooperation. Nevertheless the need to take concrete actions was only felt in late 1960s, when the system of Bretton Woods collapsed. The decline and collapse of the Bretton Woods system was indeed a main catalyst in the process of European monetary integration. But was this because the customs union was threatened? It is indeed obvious that all developments of early European integration happened in the monetary stable system of Bretton Woods. The common market was

[98] Barre Report, p. 3-4.
[99] Ibidem, p. 6.
[100] Ibidem, p. 4.
[101] Ibidem, p. 5.

not threatened with monetary fluctuations until the Bretton Woods system started to collapse. It seems logical that once the international monetary system was in decline problems for the well-being of EEC achievements would occur. The decisive trigger for action could therefore be seen in the need to protect achievements of the EEC (the common market and the CAP), as Mourlon-Druol has argued.[102] This is in line with the Barre Report. In the Barre Report the Commission specifically linked monetary integration to the cause of protection of the customs union. Therefore I would like to argue that in these years indeed it can be said that there is a spill-over effect.

[102] Mourlon-Druol, *The Euro Crisis*, p. 2.

Chapter 3. Early 1970s (1969-1974): the Snake

This third chapter covers the years 1969 to 1974. It starts with the The Hague summit in 1969. At the The Hague summit was decided to draw up a plan for the realisation of Economic and Monetary Union (EMU). Then I will focus on the resulting Werner Report, which was finalised in 1970. The main proposal of the Werner Report was to create economic and monetary union in three stages by 1980.[103] After that attention will be paid to the so-called Snake, a system of fixed exchange rates.

The Hague Summit

As has been outlined in the previous chapter, in the late 1960s the collapse of Bretton Woods caused monetary instability. Devaluation of the franc and weakness of the dollar caused doubts about the system of fixed exchange rates. Member states of the EEC feared that instability of the system would jeopardise the customs union.[104] Monetary integration was also stimulated by the emergence of new politicians. In Germany the pragmatic Willy Brandt was chosen to be Chancellor; in France, Charles deGaulle was replaced by Georges Pompidou.[105] It was the French President Pompidou who initiated the The Hague Summit in December 1969. He declared that the common market had to gain control over its own affairs.

> ''Custom duties are now a thing of the past between our countries. (…) But there are many questions which we need to answer. For instance, are the price disturbances caused by parity changes jeopardising the future of the common market (…)?''[106]

Other policy leaders agreed with Pompidou. The common market was in its final stage. Therefore it was considered that the work accomplished had to be continued and protected.[107] This was also the opinion of Willy Brandt, the German Chancellor, who stated:

> "The growing integration of the economies of our six countries has made their overall economic development increasingly interdependent. Any economic disequilibrium between them now has a

[103] Scheller, *The European Central Bank*, p. 17.
[104] I. Maes, 'On the origins of the Franco-German EMU controversies', *European Journal of Law and Economics*, (Vol. 17 2004), p. 27-28.
[105] Maes, 'On the origins of the Franco-German EMU controversies', p. 27-28.
[106] Meeting of the Heads of State or Government, The Hague 1-2 December 1969 (hereafter The Hague Summit) p. 33.
[107] The Hague Summit, p. 12.

> direct and rapid impact on the overall development of the Community. Inflationary tendencies in one country soon become a threat to the stability of another and to equilibrium within the Community. This leads to distortions and restrictions on movements of goods services and capital (...). This type of development can harm the Community as a whole."[108]

Brandt argued that this development created a need for the establishment of a European Reserve Fund, to which the German government would fully contribute, even when that would mean that a certain proportion of German currency reserves would have to be transferred into such a fund.[109] There is a strong link between integration of economics and inflation problems. It is stated that the customs union is distorted by this problems.

In the Final Communiqué of the Hague Summit of 2 December 1969 EEC countries agreed on the necessity of Economic and Monetary Union. They stated that a plan in stages should be drafted by the Council during 1970, "with a view to the creation of an economic and monetary union."[110] This would be based on the harmonisation of economic policies. It was further stated that the possibility of a European reserve fund had to be investigated.[111] The Community asked Pierre Werner, Luxembourg Prime Minister, to set up a committee of experts to investigate monetary integration.[112] The Hague Summit was thus an important stimulus for monetary integration.

Ostpolitik/Westpolitik

Brandt's outspoken opinion was not only influenced by economic interdependency, but also by the geopolitical east-west situation. When Brandt became Chancellor in 1969 his main priority was the so called 'Ostpolitik', a foreign policy that aimed normalisation of relations with East Germany and the Soviet Union. He wanted to normalise West Germany's ties with Communist Europe and overcome the division of Germany as was the case after the Second World War.[113] Eventually, Brandt hoped, West and East Germany could reunite again. This was not what the United States and France wanted. US President Nixon and Secretary of State Kissinger feared that Ostpolitik strengthen the

[108] The Hague Summit, p. 39.
[109] Ibidem.
[110] Ibidem, 15.
[111] Ibidem.
[112] Marsh, *The Euro*, p. 57.
[113] Regierungserklärung von Willy Brandt (Bonn, 28. Oktober 1969), (http://www.cvce.eu/de/obj/regierungserklarung_von_willy_brandt_bonn_28_oktober_1969-de-bc31ee73-abb3-409f-829a-3f1dae3571d4.html), p. 3.

position of the Soviet Union in Europe.[114] France also saw Ostpolitik as threatening. Political emancipation of West-Germany in Europe would diminish French influence in Europe and rapprochement between Germany and the Soviet Union would harm the Community as a whole.[115] To keep a balanced policy situation and not disturbing relations with Western countries Brandt also had a 'Westpolitik' of which monetary cooperation was part.[116] In his first remarks on the Ostpolitik Brandt also stipulated the importance of good relations with western countries, both the United States and the EEC-countries. He specifically linked his Ostpolitik with strengthened German commitment to the EEC.[117] In a conversation with Pompidou Brandt clearly stated that Germany – the Bundesrepublik – was a Western country and that only as such it would try to achieve normal relations with the Eastern countries.[118]

In the early 1970s several attempts were made. The non-aggression Pact with the Soviet-Union (August 1970), the Treaty of Warsaw between West-Germany and Poland (December 1970) and the Four-power agreement regarding Berlin's status (1971) were all actions inspired by Ostpolitik. The Basic Treaty in 1972 between East- and West-Germany was also a significant achievement. The basis was made for further normalisation of East-West relations in Europe.[119] Brandt declared in April 1970 that all German actions aimed at achieving better relations with the Eastern countries, notably East-Germany, 'sei aber keine isolierte Aktion, sondern Teil unserer europäischen Politik. Wir wollten ein geeintes Europa, verbunden mit den Vereinigten Staaten und von dieser Basis aus die Entspannung mit dem Osten'.[120] This Westpolitik, Brandt continued, was of great importance and this had become clear at the Summit in The Hague and subsequent developments.[121] The West-German government also said that all initiatives to start talks with Moscow and Warsaw were based on strong commitment with the EEC. Only as part of the EEC could the West-German government strive for

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[114] N. P. Ludlow, *European Integration and the Cold War: Ostpolitik – Westpolitik, 1965-1973* (New York 2007) p. 163-164.
[115] F. Bozo, *Two Strategies for Europe: De Gaulle, the United States, and the Atlantic Alliance* (Lanham 2001) p. 193; Ludlow, *European Integration*, p. 54-55; Dinan, *Europe Recast,* p. 127.
[116] Moravcsik, The Choice for Europe, p. 244.
[117] Regierungserklärung von Willy Brandt, p. 3, 20-21.
[118] Gespräch des Bundeskanzlers Brandt mit Staatspräsident Pompidou in Paris, 30 Januar 1970, *Akten zur Auswärtigen Politik der Bundesrepublik Deutschland, 1970 Band 1: 1 Januar bis 30. April 1970* (München 2001) Doc. 29 p.119-120.
[119] Ludlow, *European Integration*, p. 163.
[120] Deutsch-britisches Regierungsgespräch in London, 2. März 1970, *Akten zur Auswärtigen Politik der Bundesrepublik Deutschland, 1970 Band 1: 1 Januar bis 30. April 197* , (München 2001) Doc. 82 (p. 335-336.
[121] Ibidem.

East-West détente. The government went even further by stating that normalisation of East-West relations was also in the interest of other EEC-countries and that it was partly for the well-being of the EEC that this policy was implemented.[122]

West-German loyalty to the EEC and furthergoing integration was thus used to reassure other actors that West-Germany was a reliable partner, and as such Ostpolitik could be carried out. Westpolitik was complementary to Ostpolitik.[123] A further going integration with the EEC-countries could serve as an offset for improved relations with the Eastern European countries. This geopolitical goal was Brandt's primarily motivation. Therefore this Ostpolitik can be seen as a major impetus for the monetary integration in these years, which is something most scholars do agree on.[124]

Werner Report

In October 1970 the 'Report to the Council and the Commission on the realisation by stages of Economic and Monetary Union – Werner Report' (hereafter 'Werner Report') was finished. This was the start of the EMU-process, the process of Economic and Monetary Union. In the Werner Report it was said that the common market would be in danger if economic and monetary policies were not harmonised. The customs union was acknowledged as one of the most important achievements of the Community. According to the Report,

> "The experience of recent years has clearly shown that [general economic disequilibrium in the member countries] is likely to compromise seriously the integration realized in the liberation of the movement goods, services and capital."[125]

The Werner Report argued that economic and monetary union would stimulate welfare in the Community by realizing "an area within which goods and services, people and capital will circulate freely and without competitive distortions, without thereby giving rise to structural or regional disequilibrium."[126] Concerns about, and confirmation of the

[122] Gespräch des Bundesministers Scheel mit Ministerpräsident Rumor in Rom, 8. April 1970, *Akten zur Auswärtigen Politik der Bundesrepublik Deutschland, 1970 Band 1: 1 Januar bis 30. April 1970* (München 2001) Doc. 149 p. 578.
[123] Ludlow, *European Integration*, p. 175.
[124] Marsh, *The Euro*, p. 58-59; Maes, 'On the origins of the Franco-German EMU controversies', p. 27-28; Ludlow, *European Integration*, p. 74-75; Moravcsik, *The Choice for Europe*, p. 244, 250; Dinan, *Europe Recast*, p. 131; Bozo, *Two Strategies*, p. 193.
[125] Report to the Council and the Commission on the realisation by stages of Economic and Monetary Union in the Community (Werner Report), (herafter Werner Report), October 1970, p. 7-8.
[126] Werner Report, p. 9.

common market was thus in the Werner Report clearly present.

The Werner Report gave specific recommendations for the minimum that must be done to achieve an economic and monetary union. Inside the boundaries of the Community there should be convertibility of currencies. Margins of fluctuation in exchange rates should be eliminated. Instead of fluctuation there should be fixed parity rates, and free movement of capital was necessary. To some extend monetary and economic policies would have to be centralised when issues were at stake such as liquidity, interest rates, intervention in the foreign market and policies about currency reserves in central banks.[127] One of the measures intended by the Werner Report was about narrowing the fluctuation margins between the currencies of the member states.[128]

This proved to be extremely difficult in the years to follow. An international monetary crisis caused problems for monetary integration in the Community. In May 1971 growing problems with the trade balance of the United States triggered a flow of money through speculations towards the Community. The German mark was undervalued. Therefore 8 billion dollars floated from the United States to Germany.[129] This was problematic for Germany, for capital inflows endangered price stability. Between 1971 and 1973 dollar depreciation caused an inflow of capital towards Germany and outflows of capital from EEC-countries with weaker currencies. Germany was pressured to inflate its currency intern or to revalue its currency.[130]

The problem of the overvalued dollar and the undervalued EEC currencies could be solved with a float of the exchange rates. Because of its high inflation rate Germany was willing to do so. France and Italy, which currencies were also was undervalued, were nevertheless not willing to revalue the franc and lira.[131] An individual floating of the mark was disadvantageous, for the mark would be a more expensive currency compared to other EEC-currencies. This would create problems for German exports and also for intra-EEC trade. Nevertheless Germany and the Netherlands choose to float their currencies. This was a solution for some aspects of the crisis, but it became also clear

[127] Werner Report, p. 9-10.
[128] Ibidem, p. 28.
[129] European Communities Monetary Committee, Thirteenth Report on the activities of the Monetary Committee, (Brussels February 1972) p. 5-7.
[130] Marsh, *The Euro*, p. 63-64.
[131] Tsoukalis, *The Politics and Economics of Economic Integration*, p. 112-114.

that countries were unable to act united.[132] In July and August 1971 the dollar proved to be overvalued again.[133] Therefore the dollar was no longer linked towards gold and the dollar's convertibility into gold was abolished. As a result of that decision currencies became worth what the market determined and could float from time to time. Obviously this was a bad thing for the common market. The Smithsonian Agreement was meant to adjust fixed exchange rates. The dollar devalued by 10% against main world currencies.[134]

The Snake

In March 1971 the Member States agreed to realise an economic and monetary union. As part of the first stage of EMU the EEC-countries established a system for the progressive narrowing of the fluctuation margins of the members' currencies. This system became known as the 'Snake' and started to operate in April 1972.[135] It was decided that fluctuations between EEC-currencies had to be lower than 2,25%. So there was a system of fixed exchange rates between the currencies in the Community, within the broader system of fixed exchange rates between the European currencies and the dollar. This was called 'the snake in the tunnel'. In the Basel Agreement of April 1972 the Snake was created and also five non-EEC countries participated: Britain, Ireland, Sweden, Norway and Denmark. After two months British and Irish currencies were forced to leave the Snake because of several speculative attacks.[136] British reserves shrunk with 2.6 million dollar. French and Italian currencies were also having trouble and Italy was forced out in early 1973. At the same time the German mark was facing further upwards pressure. The Bundesbank and the German government spoke about a further tightening of capital control.[137] Despite this strengthened commitment of Germany the Snake was severely harmed.

Success of the Snake depended on stability of currencies. The fixed exchange rates system was in trouble when member states were unable to protect their

[132] Tsoukalis, The Politics and Economics of Economic Integration, p. 117.
[133] European Communities Monetary Committee, p. 5-7.
[134] Marsh, *The Euro*, p. 65-66.
[135] Scheller*, The European Central Bank*, p. 18.
[136] Ludlow, *The Making*, p. 2-3; Moravcsik, *The Choice for Europe*, p. 293-294.
[137] Marsh, *The Euro,* p. 66.

currencies from speculative attacks.[138] This was all at the same time with the dollar being in crisis. Huge amounts of US capital were flowing toward EEC countries. It was again the German mark that was attacked by this capital inflow because of its strong economic performance. If Germany would decide to float or revalue the German mark the Snake would be strongly affected. In early 1973 huge dollar inflows put pressure on the German mark. Interest rates were rising faster in EEC countries than they were in the USA. High demand for the mark forced the Bundesbank to buy 18 billion foreign currencies, which was a huge drain for German reserves.[139] US devaluation led the German government, backed by Bundesbank president Otmar Emminger, to start negotiations regarding a joint European float.[140]

In March 1973 it was decided to keep EEC exchange rates stable towards each other, while the Snake was allowed to float freely and depart from the 'tunnel'. This was, together with the end of the dollar's convertibility to gold, the end of the Bretton Woods system.[141] Problems remained strong, despite agreement on a joint float. The German mark was forced to revalue by 5.5% in June 1973, shortly afterwards the Dutch guilder was forced to revalue by 5%.[142] Also the franc was faced with difficulties, from the moment that it entered the Snake on. In 1973 elections were nearby, and the political left seemed to be favoured. Therefore Pompidou was not willing to restrict wage increase and government spending. The oil crisis, together with increasing German interest rates and growing French consumption, made it difficult to devalue the franc. France had therefore to leave the Snake in January 1974 and let the franc float.[143]

In October 1973 the Arab-Israel war caused an oil crisis. Western economies that were already under pressure were faced with increased unemployment and inflation.[144] In January 1974 France was suffering from strains on the balance of payments, which was worsened by the oil crisis. In order to make its industry more competitive and to protect French foreign currency reserves it was decided that the franc would float independently. This was the end of EMU.[145] Transition to the second phase, as was laid

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[138] Tsoukalis, *The Politics and Economics of European Monetary Integration*, p. 120-124.
[139] Ibidem.
[140] Moravcsik, *The Choice for Europe*, p. 251.
[141] Marsh, *The Euro*, p. 68-69.
[142] Tsoukalis, *The Politics and Economics of European Monetary Integration*, p. 128.
[143] Moravcsik, *The Choice for Europe*, p. 266.
[144] Dinan, *Europe Recast*, p. 126.
[145] Tsoukalis, *The Politics and Economics of European Monetary Integration*, p. 129-131.

down in the Werner Report, proved to be infeasible.[146] The Snake had been in continuing trouble because of capital inflows and repeatedly revaluations of the mark. Nevertheless in this problems it became clear that governments were unwilling to commit to the greater goal of monetary integration and instead were focusing on short-term economic considerations.[147] Countries differed often greatly over the Snake and other forms of monetary cooperation. Therefore it was extremely difficult for the Snake, that nearly functioned as a fixed exchange rate system, to perform well in a time of strong international monetary fluctuations. This further stressed the need for a monetary stable EEC, so that, next to other things, its internal trade and agricultural policy would be protected.[148]

Conclusion

Dollar depreciation and monetary instability in 1969 was seen as a true challenge for the common market. This is argued at the The Hague Summit, where both Pompidou and Brandt stipulated the need to preserve the common market and ensure monetary stability. In this statements it becomes clear that preservation of the common market is of crucial importance for monetary integration. The Werner Report emphasises too that the customs union would be jeopardised if monetary and economic harmonisation was not provided. It was agreed to establish Economic and Monetary Union. Therefore the Snake was created. However, by the mid-1970s the process of integration had lost momentum under the pressure of divergent policy responses to the economic shocks of the period. The "snake" had become an exchange rate mechanism among currencies of Germany, the Benelux and Denmark. For a while the non-Community Swedish and Norwegian currencies were also part of the system. Other EEC-currencies remained outside the system for all or most of its existence.[149] In this period main monetary instability was caused by dollar instability. EEC-countries decided on a joint float. Nevertheless in 1974 speculative attacks caused France to leave the Snake. This was the end of the Snake and EMU.

Again it can be said that preservation of the common market was an important

[146] Segers, *Reis naar het continent*, p. 185.
[147] Tsoukalis, *The Politics and Economics of European Monetary Integration*, p. 130.
[148] Mourlon-Druol, *The Euro Crisis*, p. 3.
[149] Scheller, *The European Central Bank*, p. 18.

argument for monetary integration. In secondary literature this is argued, mainly by Tsoukalis and Mourlon-Druol, but primary sources support this argument too. Pompidou, who spoke about jeopardising the common market, and Brandt both underlined this clearly at the The Hague Summit. This argument is also confirmed in the Werner Report. Nevertheless it cannot be argued that this was the main reason for monetary integration. Another important reason for EMU was Willy Brandt's Ostpolitik. Furthermore, national economic interests were indeed present in the reactions of countries when they were faced with international monetary instability. Only in March 1973 they could take a joint position. This strengthens Moravcsik's theory. Therefore my argument is that the customs union was indeed of significant influence in pushing monetary integration forward, but other issues are of key importance as well. It can therefore not been said that in the early 1970s the spill-over effect was the crucial issue that spurred monetary integration. The neofunctionalist theory is less well applicable for this period.

Chapter 4. Late 1970s (1974-1979): the European Monetary System

In 1977 Tsoukalis wrote: 'It is more likely that progress towards EMU will result from internal rather than external preoccupations. If the customs union appears to be in jeopardy', an urgent felt need to protect intra-EEC trade would be present. On the other hand he stipulated the monetary policy of the U.S.[150] In this chapter I will examine if protection of the customs union is indeed a main reason for monetary integration in these years. The late 1970s are marked with huge monetary instability again, but also in these years a lot of attempts were made that would result in the establishment of the European Monetary System. First I will say something about the Snake, which was again facing problems. Than attention will be paid to several proposals that aimed to stimulate monetary integration. Particular emphasis is paid to the proposal by the German Chancellor Schmidt. After that I will discuss the Bremen and Copenhagen summits, and examine what underlying motives are. Finally I will examine the Brussels summit and the European Monetary System itself.

The Snake in trouble again

In 1974 Giscard became French President and Schmidt became German Chancellor. Both were faced with economic problems after the collapse of the Bretton Woods system and the sharp rise in oil prices.[151] Also Harold Wilson, who became British prime minister in March 1974, was an important person in these circumstances. The three leaders were driven together by economic problems. As a result of the oil price rise inflation was unusually high in the EEC and had risen to 24% in Italy, 16% in the United Kingdom, 12% in France and 7% in Germany. The Italian balance of payments problems would cause a further lira decline. This could damage European trade, and in particular German exports. It was arranged therefore that $2 billion German credit flowed towards Italy, secured by part of Italy's gold holdings.[152] After Giscard had become French President, he imposed austerity, raised taxes and restricted credit. This resulted in a positive trade balance. France re-entered the Snake again.[153] In July 1975 the French

[150] Tsoukalis, *The Politics and Economics of European Monetary Integration,* p. 174-175.
[151] Marsh, *The Euro*, p. 77.
[152] Ibidem, p. 78-79.
[153] Moravcsik, *The Choice for Europe*, p. 266.

government decided to return to the Snake at the same parity at which it had left the Snake, despite German hopes for a French devaluation by 5%. In the spring of 1976 capital started to drain from the weak currency countries.[154] In March 1976 France lost a quarter of its reserves in heavy interventions to protect the franc. In 1976 however the current-account balance was again undermined and France had to leave the Snake for the second time. France's department from the Snake was the end of the Werner Plan and EMU.[155]

Monetary proposals

In these years monetary integration was not very present in EEC politics. However there were some ideas about monetary integration. In September 1974 the French came with the Fourcade plan for monetary integration. This plan was based on use of currency support instruments and an increase in credits. A basket of Community currencies was proposed as a new unit of account as a reference value for the snake. This would counterbalance the Mark and result in greater monetary symmetry for the countries with regard to each other. Nevertheless the other countries rejected the plan because it would involve an extension of credit facilities.[156]

In political and institutional terms in these years also the creation of a new institution was carried out. In Paris, December 1974, the EEC heads of government decided that from they would meet three to four times a year as the European Council. This new institution would play an important role in European integration. The European Council wanted to ensure consistency in developing European integration and to give this integration new momentum.[157]

In the years to follow several proposals for monetary integration were made. One of these plans was the Duisenberg Plan, that was initiated in 1976. This plan wanted a convergence between currencies within the Snake as well as with currencies outside the Snake. It was based on the creation of a Community framework of consultation and supervision of exchange rates. The plan did not require active interventions to keep currencies within their target zones, but it prohibited policies that would have an ill-

[154] Archive and Documentation Centre (CARDOC) Journals, Directorate-General for the Presidency, European Parliament, 'The long road to the euro' (February 2012), p. 29.
[155] Marsh, *The Euro*, p.71-73.
[156] Ibidem, p. 80.
[157] Segers, *Reis naar het continent*, p. 205-206; Mourlon-Druol, *The Euro Crisis*, p. 5-6.

fated effect on these currencies.[158] Unlike these proposals a proposal by Commission President Roy Jenkins succeeded in driving monetary integration forwards, for it revived debates.[159] For Jenkins monetary integration was the centrepiece of his EEC policy for the next four years.[160] In 1977 the Commission presented a plan on monetary matters. The plan tried to link monetary cooperation with an increase in Community powers on fiscal policies, with the perspective of the creation of a European currency, for which the European unit of account played an important role.[161]

Roy Jenkins explained the reasons for the plan, which was presented first to the Ecofin Council in November and then to the Brussels European Council in December 1977, in a speech to the European University Institute in Florence on 27 October 1977. For Jenkins problems raised by the international economic crisis could not be solved by each country on its own, but only through a common currency issued by a European monetary authority. This would have a major impact in tackling inflation and unemployment, and stimulate industry and trade. Jenkins' ideas were not that well received. His plan about strengthening Community powers on fiscal matters was considered excessive and was not followed up, but it was agreed at the Brussels European Council of 5 and 6 December 1977 that the Community budget would be drawn up in units of account from 1978.[162] Jenkins' proposal was also the reason that talks about monetary integration were renewed.[163] During the first months of 1978 other changes were also important incentives for monetary integration. The French government's victory in the general elections was a precondition for monetary integration. Had the French Left won the elections of March 1978, this would have had serious economic consequences for France, for the Left favoured expansionist policies instead of stability-oriented policies.[164] The change of mind of the German Chancellor Schmidt also had great impacts on negotiations. Schmidt decided in early 1978 to come

[158] CARDOC Journals, 'The long road to the euro', p. 32.
[159] Mourlon-Druol, *A Europe made of money*, p. 3.
[160] Ludlow, *The Making*, p. 40, 43-47; Moravcsik, *The Choice for Europe*, p. 295.
[161] CARDOC Journals, 'The long road to the euro', p. 32.
[162] Ibidem, p. 32-33; Ludlow, *The Making*, p. 55-61.
[163] Mourlon-Druol, *A Europe made of money*, p. 158-159.
[164] Ibidem, p. 155.

up with a new initiative for a European monetary that would result in the creation of the EMS.[165]

Schmidt's initiative

In the summer of 1977 the dollar caused widespread instability again. This decline of the dollar was due to causes as a miner's strike, inflationist trends, the balance of payments deficits and so on. The American balance of payments was suffering structural deficits.[166] Between October 1977 and February 1978 the situation worsened due to dollar depreciation by 12% against the mark, which led to upward pressure of the mark.[167] It was in particular Germany that saw itself faced with an appreciation of the Mark. German money supply kept growing, causing fear for inflation and stability in Germany. The mark floated upwards compared to other European currencies. Germany could either devalue the mark, which would have serious consequences for its exports, investments and employment, or could let the Bundesbank buy quantities of dollars to keep the exchange rate low. The latter would increase German money supply and cause inflation issues. The German government had therefore a good reason to argue for a system in which the dollar's position would have less influence on stability of exchange rates with Germany's main trading partners.[168] Schmidt's worries regarding the dollar crisis, his fear for Germany to be forced to reflate its currency, and his diminishing confidence in U.S. leadership were the main reasons for his monetary proposal.[169] Another issue was that all EEC countries were having problems regarding slow economic growth and exchange rate instability.[170]

Schmidt was worried about these problems. He also distrusted the American President Carter and his economic and monetary policy.[171] Mostly because of the dollar's decline and the dependency of EEC currencies of the dollar, Schmidt came with a proposal for monetary integration. He saw the European Community as the right institution for dealing with disorders originating from the dollar crisis and the weak Carter government.[172] Schmidt also strongly disagreed with Carters policies on human

[165] L. Tsoukalis, *The New European Economy. The Politics and Economics of Integration* (New York 1991), p. 165, 169; Ludlow, *The Making*, p. 61.
[166] Mourlon-Druol, *A Europe made of money*, p. 143-144.
[167] Moravcsik, *The Choice for Europe*, p. 251-252, 256.
[168] Ibidem; Ludlow, *The Making*, p. 63, 71-73.
[169] Ludlow, *The Making*, p. 61-62, 69.
[170] Mourlon-Druol, *A Europe made of money*, p. 183-184.
[171] Marsh, *The Euro*, 83; Ludlow, *The Making*, p. 63-69.
[172] Ludlow, *The Making,* p. 63-64; Dinan, *Europe Recast,* p. 173-174.

rights and nuclear issues. Against this background he initiated his ideas on monetary cooperation.[173] He presented this on 12 March 1978. His plan was to create a new and improved kind of snake. Each member state would put half of their reserves into a new currency pool. Their currencies would be fixed against a European Unit of Account. The European Unit of Account would be linked toward the dollar and become the unit of intervention. If member states were having problems they could borrow from this currency pool. The pool should be intergovernmentally managed by Finance Ministers.[174] Schmidt himself declared lateron:

> ''The European system is certainly not directed against the dollar. But if it could make us a bit more independent of dollar fluctuations – something I do not exclude – that would certainly be welcome. (…) It would also be European political progress''.[175]

The French President Giscard was positive about Smiths proposal. It was not easy for France to return to the Snake, for the franc opted out twice. Therefore a fixed exchange rate regime was a possibility for France and Giscard was willing to go along with the initiative of Schmidt. On the other hand, the British prime minister Callaghan believed that Schmidt's ideas meant a turn away from the dollar and the financial policy of the United States and that was the main reason why Callaghan was reluctant to support the proposal.[176] In a British ministerial meeting Mr. Couzens stated that 'it would look too much like ganging up with the Germans against the United States', with which the prime minister agreed.[177] Again it was proved that American policies were having a decisive influence on the process. At the Copenhagen meeting it was decided that an ad hoc group would research Smiths ideas.[178] Their work would be discussed at the meeting of the European Council in Bremen in July.

Reasons for the Schmidt initiative

Moravcsik states that this – the creation of the EMS as a reaction on US inflation and the position of the dollar - is an economic argument. As said before in Chapter 1, the two opposed groups in Germany – exporters who favoured a fixed exchange rate system in

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[173] Ludlow, *The Making,* p. 69.
[174] Mourlon-Druol, *A Europe made of money*, p. 164-165.
[175] Bundesbank Council meeting with Chancellor Schmidt.
[176] Mourlon Druol*, A Europe made of money,* p. 167.
[177] Ministerial Meeting on EMS: Note of a meeting held in the cabinet room at 1845 on Tuesday 4 April 1978, Margaret Thatcher Archive (http://www.margaretthatcher.org/document/111475).
[178] Mourlon Druol, *A Europe made of money*, p. 172.

which their competitiveness was assured, and domestic firms together with the Bundesbank, who favoured a strong anti-inflation policy and cared less about competitiveness – constituted a main impetus for the German government to go on with monetary integration. In times of dollar decline goals of both export competitiveness and low inflation could no longer be maintained. In these cases Germany was pressured to either revalue the mark or inflate domestically. Coordination of currencies would prevent Germany from being vulnerable to dollar depreciation.[179]

On the other hand it might be said that high politics were also involved. As we have seen, Schmidt's mistrust of U.S. politics was a major reason for him to support a European Monetary System.[180] Furthermore, according to the German Chancellor Schmidt, Giscard argued that France needed EMS, for in this way it would be able to increase export and catch up with the German economic position. Otherwise German economic hegemony in Europe would prevail and endanger both the French future and EEG's future.[181] Schmidt believed that this was exaggerated, but he also stated that Giscards worry had an important true core:

> "Die von der Bundesbank erstrebte totale D-Mark-Autonomie lief im Erfolgsfalle auf eine klare währungs- und kreditpolitische deutsche Dominanz hinaus. Zum andern hatte auch ich selbst immer das EWS nicht nur als Instrument zur Harmonisierung der ökonomischen Politiken der EG-Mitgliedsstaaten angesehen, sondern zugleich als gesamtstrategisches Element zur Festigung der politischen Eigenständigkeit Europas. Um dieser beiden Ziele willen hatte ich keine inneren Schwierigkeiten, Giscards Argumentation zu ertragen."[182]

So Schmidt himself claimed that EMS was not only needed to harmonise economic policies, but is mainly part of a broader strategy for strengthening the European political autonomy. Schmidt also claimed that part of his goals regarding EMS is currency stability, for this will have impact on intra-European trade and therefore the convergence of the EEC. Furthermore he aimed with the Ecu to create an 'einheitliche europäische Währung (…), die der weltwirtschaftlichen Bedeutung des Dollars und des japanischen Yen endlich gleichkäme.'[183] It is not only about economic goals, but also geo-political goals like convergence of the EEC and the position of EEC-currencies compared with currencies of the United States and Japan that have to do with the creation of the

[179] Moravcsik, *The Choice for Europe*, p. 245-249.
[180] See also Bundesbank Council meeting with Chancellor Schmidt.
[181] Helmut Schmidt, 'Kampf gegen die Nationalisten', Die Zeit (31 August 1990).
[182] Schmidt, 'Kampf'.
[183] Ibidem.

EMS. Also Giscard seems to have high-political goals involved with his efforts for creation EMS.

Bundesbank Council meeting

On 26 November 1978 Schmidt had a phone call with Callaghan, the British prime minister. He made clear that he had problems with his Central Bank Council regarding the European Monetary Scheme. The bankers were opposing this because they feared destabilisation.[184] Four days later, at a secret meeting with the Bundesbank Council in Frankfurt, Schmidt laid out his rationale for European monetary integration and the EMS in order to won over the German bankers. The records of this meeting made clear that Smith was worried mainly because of political aspects. He spoke of the relationship between France and Germany and stated that both countries must belong to a common monetary area in order to assure political stability.[185] He went further by saying that Germany's foreign policy would not be conducted successfully without a good functioning European Community. The two pillars for a German foreign policy, according to Smith, were the North Atlantic alliance and the European Community. If one of these pillars would collapse, German foreign policy could no longer exist. Smith linked the common market strongly to the Second World War ('Auschwitz') and the German vulnerable position, divided in an Eastern and a Western part ('Berlin').[186] The European Monetary System was necessary 'to cover our foreign policy nakednesses, like Berlin or Auschwitz' and was 'a vital precondition' for German autonomy and its foreign policy.[187] Schmidt therefore emphasised almost only political reasons for Germany to participate in the European Monetary System. Mr Wertz was critical about Schmidt's 'grand foreign policy scenario' and underlined that members of the council of the Bundesbank were not the right persons to discuss German foreign policy. Schmidt assured that the rules of the new system would not be taken too literally, if and when this rules conflicted with German interests.[188] He emphasised again the devastating

[184] Callaghan-Schmidt phone call; 'Prime Minister's Conversation with Chancellor Schmidt at approx. 1605 hrs, Sunday 26 November 1978', Margareth Thatcher Archive (http://www.margaretthatcher.org/document/111567).
[185] Bundesbank Council meeting with Chancellor Schmidt.
[186] Ibidem.
[187] Ibidem.
[188] Margaret Thatcher Foundation, 'Britain & the Origin of EMS' (http://www.margaretthatcher.org/archive/EMS_1978.asp).

influence of the US balance of payments and the position of the dollar. Again it was obvious that the position of the dollar was very important in creating the EMS. Schmidt's geopolitical reasons were of determining impact on his acting, like was the case with Brandt before him and also Adenauer, as Schmidt himself noticed.[189] Of course Schmidt also stated that there were good economic reasons too, but these reasons were only shortly mentioned and it is likely that they are mainly there to support his larger goal of political autonomy.

Regarding preservation of the customs union, this is more difficult to be seen as the rationale behind monetary integration in these years. Not only has the customs union not been mentioned in secondary literature that handles this period, it was also true that currency fluctuations did not undermine intra-EEC trade so obviously.[190] According to Otmar Emmiger of the German Bundesbank, significance of fixed exchange rates for capital movements and trade is often overrated. For instance German exports towards France, Britain and Italy (three main EEC-countries with floating exchange rates against the D-mark) increased significantly faster than exports to other countries in 1975 to 1978.[191] Nevertheless at this meeting in Frankfurt Schmidt argued:

> "The first point that I would like to emphasise to you is that this is about saving the Common Market in general. The Common market is the basis and centre-piece of the European Community. (…) It is alarming that since 1973, since the monetary turbulence made itself everywhere fully noticeable (…), the exchange of goods within the Community has grown more slowly than world trade."[192]

Smith continued by saying that stable rates of exchange are necessary for the success of the common market, since exchange rates floating against each other are a real problem:

> "Should we not succeed in restoring this previously self-evident condition for the Common Market, then the members of the 'Snake' and the outside floaters will drift further apart, and that will bring into question not only the economic but also from the long view the political cohesion of the European Community".[193]

Clear from these citations are Smith's worries regarding the problems for the common market, which he equates with the customs union. He refers to Italy, which had to cash deposits on imported goods because of monetary divergence, and called this 'the first

[189] Bundesbank Council meeting with Chancellor Schmidt.
[190] Mourlon-Druol, *A Europe made of money*, p. 271.
[191] O. Emminger, *Verteidigung der DM. Plädoyers für stabiles Geld* (Frankfurt am Main 1980) p. 207-208.
[192] Bundesbank Council meeting with Chancellor Schmidt.
[193] Ibidem.

signs of the disintegration of the customs union'.[194] Ms. Dingwort-Nusseck of the Bundesbank Council replied and said that disintegration in trade was not supported by statistical evidence. Indeed, in 1974 world trade had exploded after the oil crisis, but trade within the EEC had grown stronger again in every subsequent year.[195] This is largely the same as Emminger later would argue.[196] Schmidt acknowledged that trade within the EEC might have grown. He explained his argument. In the first fifteen years of the EEC intra-community trade grew significantly faster than external trade did, and it was this trend that has been broken en made Schmidt worrying.[197]

Copenhagen and Bremen, early 1978

In the Memorandum for the European Council in Copenhagen, Commission President Jenkins emphasised the need for constructive proposals for endorsement. This had to be based mainly on both the sluggish average growth rate and the chaotic international monetary system. Regarding sluggish average growth rates and decline of competitiveness in several sectors was not only problematic for national economic interests, but also for the integration of the Community market. Jenkins argued that intra-Community trade grew in 1977 by only 2%, while in the previous decade this was an average of 9%. This required action. Action was also needed because of the international monetary situation. Jenkins emphasised the decline of the Bretton Woods systems, but also said that one feature of this system does continue: the monetary predominance of the dollar. This 'greatly affects our intra-community relationships and the nexus of the Euro-currency markets as well as our trading position with the rest of the world.' Therefore, according to Jenkins, scope existed for the EEC to develop use of the European unit of account in complementing the snake system.[198]

In Schmidt's notes of remarks at the European Council meeting in Copenhagen it becomes clear that he is worried about the decreasing intra-Community trade in 1977 and the trade deficit compared to the OPEC countries (Organisation of the Petroleum Exporting Countries). He asks himself how they did get into this, and speaks first of US

[194] Bundesbank Council meeting with Chancellor Schmidt.
[195] Ibidem.
[196] Emminger, *Verteidigung der DM*, p. 207-208.
[197] Bundesbank Council meeting with Chancellor Schmidt.
[198] Commission of the European Communities, 'Memorandum for the European Council, Copenhagen 7/8 April 1978' (3 April 1978), Margaret Thather Archive (http://www.margaretthatcher.org/document/111532).

inflation and the US balance of payments deficit. 'The question is what we can do to turn the tide. Closer monetary cooperation' and 'a larger role for the EUA which might well become a monetary instrument peculiar to the community. (…) might well replace the dollar as a means of settlement'.[199]

The worldwide monetary situation was thus seen as a strong impetus for cooperation between the member states. At the meeting of the European Council in Bremen, July 1978, discussions were centred on monetary questions. The German Presidency stated that a monetary zone was highly desirable 'in the face of the dangers resulting from the serious disruptions of the world economy'.[200] Also Commission President Jenkins stated again that the time was ripe for new moves in the monetary field:

> "In my view we should seek greater exchange rate stability between the currencies of member states of the Community and thus a stronger basis on which to deal more effectively in exchange rate policy with third countries, notably the United States."[201]

Jenkins thus said that greater exchange stability between the EEC-currencies was important to deal with the dollar. Again it was pointed that there were serious disruptions in the international economic and monetary system. The introduction of ideas for closer monetary integration should therefore lead to a zone of monetary stability. The Council agreed on this objective.[202] It was decided that the Finance Ministers would formulate guidelines and provisions necessary for an effective scheme at their meeting on 24 July 1978. On the European Council meeting on 4 and 5 December 1978 a final decision would be taken based on this research.[203] Despite the fact that at this meeting no binding decisions were taken, the European Council set guidelines towards an agreement. At the centre of the system would be the European Currency Unit (ECU). This would be used as a technical unit for central bank interventions and could

[199] Schmidt note of remarks on EMS; 'The case for More Intra-European Monetary Cooperation. Summary of Comments Made in Copenhagen on April 7, 1978', Margaret Thatcher Archive (http://www.margaretthatcher.org/document/111534).
[200] Bremen European Council (statement by German Presidency on EMS); 'Extract from the Presidency's Statement after the European Council in Bremen', Margaret Thatcher Archive (http://www.margaretthatcher.org/document/111576).
[201] The European Council, Copenhagen 7-8 April 1978, 'European Council Agrees on Joint Economic Moves and Sets Date for Direct Elections', European Community Background Information No. 8/1978, European Community Information Service (Washington DC) (http://aei.pitt.edu/1440/1/Copenhagen_1978.pdf) p. 1.
[202] The European Council, Bremen 6-7 July 1978, p. 18
[203] Ibidem, p. 18.

later become a single currency.[204]

With regard to the preservation of the common market no remarks are made. It is agreed that the Community should take further steps to remove trade barriers and distortions of competitions in order to safeguard and develop the common market.[205] However, this is one single sentence and there are no linkages made between the common market and EMS.

EMS

At the meeting of the European Council in Brussels, December 1978, it was agreed to establish a European Monetary System (EMS) on I January 1979. In this system currencies of member states could float between a rate of 2,25%, which was similar to the previous Snake.[206] There were other alterations and improvements made with regard to the Snake, such as the divergence indicator. This is a formula that detects divergence between Community currencies. If currencies would diverge by 75% adequate measures should be taken by the authorities concerned, such as a change in economic or monetary policy. A currency that deviated from other currencies was thus obliged to act before the limits of the margins were reached.[207] It was also said that a European Monetary Fund would be established on 1 January 1981. This Fund could support and protect the EMS.[208] Because of these improvements the system was less vulnerable of speculative attacks. Again it became clear at the meeting in Brussels that worldwide monetary instability the main reason was for the EMS. This worldwide monetary instability was greatly affected by the decline of the dollar. Concern about the dollar and how its decline might affect German trade also forced Schmidt to initiate monetary cooperation. In previous years monetary integration was linked to the common market. In the final reports of the Brussels meeting no such thing is mentioned. It is stated that the EMS is also initiated because of political will as it is stated that the EMS will 'give fresh impetus to the process of European Union.'[209]

> "The European Council (...) reaffirmed its determination to proceed further along the road to an ever closer union among the peoples of Europe. This, too, was the purpose of its decisions with

[204] Marsh*, The Euro*, p. 88.
[205] The European Council, Bremen, p. 18-19.
[206] The European Council, Brussels 4-5 December 1978, p. 14.
[207] The European Council, Brussels, p. 115.
[208] Ibidem, p. 114-115.
[209] Ibidem, 113.

regard to the European Monetary System (...).[210]

The EMS was thus merely a political instead an economic reaction of the EEC countries towards mondial instability.[211]

In March 1979 the European Monetary System was established by a resolution of the European Council. Operating procedures were described in an agreement between participating central banks. The EMS was in some aspects very similar to the Snake. For instance, at the core of EMS was a grid of fixed, adjustable exchange rates among EEC-currencies. Unlike the Snake, EMS was able to keep most of its currencies in this exchange rate system. A new element was the introduction of the European Currency Unit (ECU), which was defined as a basket of fixed quantities of currencies of the EEC-countries. The ECU was meant to be a unit of account for operations in intervention and credit mechanisms, and as reserve asset for participating central banks. The EMS was helpful for participating countries with relatively high inflation levels. It fostered a downward convergence of inflation rates. This led to a higher degree of exchange rate stability. Because of the EMS it was also acknowledged that parities of participating currencies were not allowed to float significantly. This protected intra-EEC trade from excessive exchange rate volatility and speculative attacks. Despite these positive aspects, success in fostering convergence of economic policies was rather limited.[212]

The establishment of a European Monetary Fund in 1981 was not enacted, due to strong objections of the Bundesbank. Short-term and medium-term credit assistance was extended significantly. Nevertheless there was no agreement on reserve-pooling.[213] The divergence indicator did not involve an obligation to intervene.[214] Lacking sufficient convergence in fiscal policies was challenging. The creation of the EMS did not necessarily solve problems between EEC-countries. Some of these balances could be in permanent divergence, as a result of diverging levels of productivity and prices. Some countries had persistently large budget deficits which meant a heavy burden on monetary integration and would even lead to several exchange rate crises in early 1990s. Also it was stated in 1978 that the ECU should be at the core of the EMS, but in reality there was only a small role for the ECU in the functioning of the EMS.[215] In the end

[210] The European Council, Brussels, p. 121.
[211] Mourlon-Druol, *A Europe made of money*, p. 226-227.
[212] CARDOC Journals, 'The long road to the euro', p. 20.
[213] Marsh, *The Euro*, p. 93-94.
[214] Mourlon-Druol, *A Europe made of money*, p. 258-259.
[215] CARDOC Journals, 'The long road to the euro', p. 20.

EMS differed a lot from the original Schmidt-Giscard proposals. Both Mourlon-Druol and Moravcsik argue that it can be seen as the work of specialised committees in which the Bundesbank was very influential. This explains the shape of the EMS in 1979.[216] Nevertheless the value of the EMS lies not in itself, but in the fact that it is a monetary policy system based on wider political and economic consensus.[217] The EMS is also not a purely economic project. It is also significantly political. That is emphasised in the final text of the summit in Brussels, in which is stated that the EMS is an impetus for a European Union. The EMS also has potential for 'becoming a vehicle for further European unification and greater international monetary stability'.[218]

Conclusion

After the French currency had left the Snake again in 1976 monetary stability in the EEC was impaired. In 1977 and 1978 initiatives for monetary integration were launched again. This had several underlying causes. Commission President Jenkins was influential in putting EMS on the agenda again. It was the German Chancellor Schmidt, however, who gave the decisive impetus. Schmidt began to favour monetary integration due to his strong mistrust of US policies and the fact that the dollar was in decline. Capital inflows caused fear for inflation and instability and were damaging German economic interests. An European monetary system was needed to protect EEC countries against monetary instability caused by the dollar. The United States were thus having a great impact on the creation of the European Monetary System. Also political interests of Germany were of crucial impact on Schmidt's willingness to create the EMS. Monetary integration would serve as a counterbalance for Germany's foreign policy. Germany needed a stronger commitment to the EEC because the country was divided in East and West, like Brandt had argued before, and because of Germany's role in the Second World War. The EMS was also seen as a means to achieve European political unification. Both causes are further stated in records of EEC meetings, mainly in Brussels and Bremen. Regarding the customs union, this is absent in most records of meetings. The influence of the dollar becomes clear as a main motivation. However, the customs union plays a very influental role in Schmidt's meeting with the Bundesbank. In this secret meeting he tries to win

[216] Mourlon Druol, *A Europe made of money*, p. 258-259; Moravcsik*, The Choice for Europe*, p. 308-312.
[217] Mourlon-Druol, A Europe made of money, p. 259.
[218] Emminger, *Verteidigung der DM,* p. 207.

over the bankers to support the EMS and his core argument is about the customs union and its political usefulness for Germany. Moravcsik is therefore not right when he states that maintenance of the customs union was of no influence on the creation of the EMS.

Conclusion

In the introduction the main research question was formulated as follows:

What was the motivation behind the search for monetary stability and integration in the 1960s-1970s in the EEC?

Other questions that I wanted to answer were: How is the customs union related to different developments regarding monetary integration in the 1960s/1970s? Do problems regarding the customs union cause monetary integration? What other causes are there? And can it be said that there is an overarching goal, and is this rather economic or geo-political? I have tried to answer these questions by looking at the events and negotiations that led to the creation of the Snake and the European Monetary System. First I have examined whether the customs union did influence the emergence of monetary integration, and if this could strengthen the neofunctionalist argument. Second I have also paid attention to other possible causes as well. Also in traditional debates on European integration a lot has been said about the overriding objective behind certain developments. In short, this is mainly an economic objective (liberal intergovermentalism) or a geo-political goal (neofunctionalism). I have tried to examine this too for monetary integration in the 1960s and 1970s. In this conclusion I will relate earlier conclusions to the wider historiographical issue. Doing so I will provide an explanation of monetary integration in the 1960s-1970s (the creation of the Snake and the EMS).

The common market means an area of free movement of goods, services, persons and capital. Tariffs and quantitative restrictions between members were restricted. It was already agreed in the Treaty of Rome that monetary integration could be necessary for the common market. Nevertheless in the first period I researched (between 1958 and 1968, before the The Hague Summit) monetary integration was not an issue. This was largely due to the system of Bretton Woods, which resulted in widespread monetary stability. In the early 1970s the system of Bretton Woods collapsed. The Smithsonian Agreement and the 'snake' created a fixed exchange rate between the EEC-members and the United States. The snake was created as a solution to fluctuations between currencies of the EEC countries. This did not work so well, for some currencies proved strong while others were weak. In 1974 France was forced to leave the snake. This meant the end of the Werner Plan and EMU. In the late 1970s monetary integration was launched again. This led to the creation of the European Monetary System.

The collapse of the system of Bretton Woods and as a result worldwide monetary instability was an important impetus for attempts for monetary integration. In the late 1970s weakness of the dollar proved to be the key catalyst for EMS. Monetary integration was on the agenda mainly in times of dollar weakness, namely in 1969-1973 and 1977-1979. It was indeed capital mobility that was the main drive behind this integration, as Moravcsik had argued. Did capital mobility the customs union, in which free movement of goods was far better regulated than free movement of capital, hinder to such an extent that it was the main motivation for monetary integration in this period?

In the early 1970s the Commission frequently pointed the link between the customs union and the need for institutional changes. In the Barre Report this is clearly stated, as well as in the Werner Report. Also at the The Hague Summit monetary integration is strongly linked towards the customs union and free trade. Not only the European Commission, also Willy Brandt and Georges Pompidou stated that problems in the common market were the crucial reason for monetary integration. The 1960s and early 1970s are therefore a good example of spill-over. Nevertheless it must be acknowledged that there were other reasons as well, such as Willy Brandt's Ostpolitik and short-term national economic interests that prevailed.

In late 1970s preservation of the common market was barely mentioned. It was the weakness of the dollar that finally would cause monetary integration between the EEC members. Increased harmonisation and stable exchange rates would indeed have a positive effect on the common market and intra-EEC trade, but the common market can hardly be seen as the only or the most important reason for monetary cooperation in the 1970s. Virtually all literature, primary and secondary, argues that dollar depreciation is the main cause for monetary integration. It is also not the case that intra-EEC trade suffered deeply from monetary instability, as Otmar Emminger has argued. Unstable exchange rates could not hinder internal trade from growing. Weakness of the dollar damaged both national economic interests and stimulated commitment to the goal of political union. Nevertheless, in records of a secret meeting between Chancellor Schmidt and members of the Bundesbank it becomes clear that Schmidt is worried about consequences of the unstable international monetary situation for the customs union.

This is among his major arguments in favour of monetary integration. It can therefore not be said that preservation of the customs union was not one of the consequences of monetary cooperation in the 1970s. But there are several other important issues that were of great influence as well, which are not explained by the neo-functionalist theory of spill-over. Therefore preservation of the customs union and the spill-over effect cannot fully explain monetary cooperation in the 1960s and 1970s. Due to the role of the weak dollar and problems with capital inflows Moravcsik is right when he claims that capital mobility boost monetary integration. The link between the customs union and monetary integration is, however, so clearly present in the path to EMU in the early 1970s that Moravcsik is not right when he states that it is only a justification. But economic interests of national governments are also important in decision-taking regarding monetary integration and determining how the EMS finally would turn out. Notably German economic interests were important: Schmidt advocated strongly for EMS, partly because the weak dollar and U.S. economic performance could harm German export and foster inflation. In the neofunctionalist theory there is hardly any room for domestic economic preferences.

This does not say that the theory is not valid. For instance in the current Eurozone crisis the same concept of spill-over is visible. It seems perfectly logic that an economic and monetary union needs also a system that regulates fiscal and financial matters, as several scholars have indeed argued.

Second the question emerged what kind of overarching goal or ambition can be found in monetary integration in these years. In all literature it is obvious that creation of EMU and EMS is not merely an economic goal per se, but also is politically motivated. EMU and EMS are instituted out of political will rather, than economic considerations regarding protection of the customs union or related to national export and inflation. In the final text of the Brussels summit this is stated. Also by looking at the EMS itself it can be argued that it was not only an economic mechanism. To that extent Moravcsik is also not right.

Concluding I want to make the point that it was mainly the instable international monetary system that was the main catalyst for monetary integration. Because of this monetary instability preservation of the common market was indeed jeopardised in the 1960s and 1970s and this has contributed to the emergence of Economic and Monetary Union, which does confirm the spill-over theory. It must also be mentioned that in this period other important issues also contributed to EMU, such as Willy Brandt's Ostpolitik. In the late 1970s problems regarding the dollar were also a very influential argument. National economic interests and political objectives were spurred by this and were among the main motivations behind monetary integration in the late 1970s. The neofunctionalist theory can therefore not explain integration in these years entirely.

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