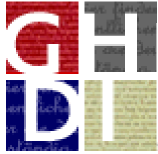

German History in Documents and Images

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The European Monetary System (December 6, 1978)

In this speech to the Bundestag, Chancellor Helmut Schmidt, one of the architects of the European Monetary System, explains why the system was established and how it differs from the previous "currency snake" implemented in 1972, following the collapse of the Bretton Woods System."* The original "currency snake" was intended to maintain stable exchange rates between EC member states by preventing exchange-rate fluctuation of more than 2.25%. Its larger objective was to encourage convergent monetary policies among EC member countries. Experience would show, however, that fixing nominal exchange rates alone was not enough to achieve this. The snake remained a feature of the European currency system until January 1, 1979, at which point the European Monetary System described by Schmidt was implemented. The European Currency Unit [ECU] was introduced as part of the European Monetary System.

Policy Statement by Federal Chancellor Helmut Schmidt on the Results of the Session of the European Council in Brussels, December 6, 1978

[. . .] Yesterday in Brussels, following the complicated work of the past weeks and months, all nine member countries [of the European Council] arrived at a joint decision to introduce the [European monetary] system on January 1, 1979. The texts were published last night and will be available to the Bundestag shortly.

This European Monetary System, as I have said previously, aims to introduce a higher degree of monetary stability, both between the individual currencies and for each individual currency domestically. One can say that it is a fundamental element in a more comprehensive strategy directed toward sustainable growth with price stability, a stepwise return to full employment, and the reduction of regional disparities.

This common monetary system will facilitate economic policy convergence within the Community and give new momentum to the [unifying] process of the European Union. We also expect, however, that this system will have a stabilizing effect on international economic and

* The Bretton Woods System was an international monetary regime that took its name from the New Hampshire town where it was set up in 1944. It sought to stabilize the international monetary market by fixing exchange rates. The U.S. dollar was the reserve currency of choice; in turn, the price of gold was fixed at $35 U.S. The Bretton Wood system started to break down in 1971 but remained in force until 1973. Whereas the Bretton Woods system was an international system (the communist countries refused to participate), the "currency snake" devised in 1972 applied only to the currencies of the original six (and after 1973, nine) EC member countries – eds.

monetary relations beyond the borders of the Community. In this respect, it will doubtless lie equally in the interest of both industrial and developing countries alike.

When I say that nine countries arrived at this decision jointly, it should be emphasized that three of them have reservations about participating in a particular aspect of the system. As expected, the United Kingdom declared that it is presently unable to participate in the common exchange-rate and intervention mechanism. The Italian and the Irish governments have declared that they need some time to consult their cabinets and the political forces supporting their governments at home to determine if they can participate in the common exchange-rate and intervention mechanism starting on January 1. We anticipate receiving statements by these two governments in the course of the next week. [. . .]

The unforeseen divergence of the currencies, which had not been taken into account when the Common Market was constructed, has produced a number of risks. We have tried to counter them with the currency group referred to as the "snake," a name that is virtually incomprehensible to anyone who is not a historian. It was possible to implement this even within a relatively small group of EC member countries. Those who did not participate in this "snake" currency group have not fared well all the time.

One can best illustrate the negative results of the drifting apart of European currencies by looking at statistics and observing how – since currency instability became particularly pronounced around 1973/74 – intra-Community economic trade has lagged relative to foreign trade outside the Community. Whereas from 1957 to 1973 intra-Community economic trade always grew faster than worldwide economic trade – as expressed by the advancing integration process of the Common Market – in the last three to four years intra-Community trade has lagged behind it world trade. This is an expression of a quantitatively significant disintegration resulting from currency differences.

If this [development] were allowed to continue for another three, four, five, or more years, I fear that it would destroy more than just the common agricultural market. That has already been destroyed by the divergence of currencies. It does not exist in reality. There is no single price for a liter of milk or a pound of butter in two European countries. At least not for the consumer; a single price exists only for the accountants. The agricultural market has already fallen apart. Agricultural exchange in Europe is more difficult today than it was fifty years ago. At that time, one only had to pay customs duties. Today one has to make incredible calculations in order to know what to ask for a pound of butter.

In addition to the disintegration of the agricultural market, the Common Market would be threatened as well. In some cases, economic policy discipline could also decrease because members of the Common Market would favor their own currencies – or to be more precise: their own balance of payments – so that within the Common Market the gap between stable and less stable national economies could continue to grow.

The decisions reached yesterday evening had been in the making for six months and were made possible by a growing consciousness of the importance of maintaining monetary stability among the member countries. If, for example, one compares the inflation rates of the European member countries in 1973 and 1974 with the inflation rates that have been reached in all these neighboring and partner countries today, it is apparent that the abatement of inflation, while still insufficient in many cases, must nevertheless be seen as an important success in reversing the perception not only of the governments in those countries, but also of their parliaments, public opinion, associations, corporations, trade unions.

While still insufficient, it is certainly a huge turnaround compared with the trends of the early 1970s, when inflation rates rose steeply, reaching double figures – sometimes even up to 20 percent annually. A reversal has taken place here. Certainly the policies of our country have had their share in this development. Only on the basis of reversing the trend being pursued by the countries can one venture to establish a monetary community like the one that will be formed now. [. . .]

The most important aspects of the exchange-rate and intervention systems are in complete agreement with the demands that were put forth jointly by the Bundesbank [German Federal Bank] and the federal government over the course of the summer and fall.

In particular, I would like to mention, first, that the obligations of all participants to intervene in the foreign exchange markets – that is, buying weak currencies with one's own currency or selling strong currencies against one's own currency, as, for example, in the "snake" up to now – have been clearly determined. These obligations for intervention have been clearly determined.

Second, no special regulations are envisioned for the settlement of balances in special cases.

The system also contains elements that definitively distinguish it from the previous currency group referred to as the "snake." Among them are: first, the European Currency Unit, or ECU, which did not exist up to now, and which is being created by the participating central banks with deposits of gold and foreign currencies.

The experts speak here of ECU I, since later there will also be an ECU II – when the European Monetary Fund will be legally established through a treaty requiring ratification. It will be possible to obtain ECU II from the European Monetary Fund under certain circumstances and with limited tranches against payment with one's own national currency. But we are not at that point yet.

"ECU" is a French pronunciation of the English acronym for European Currency Unit. I have nothing against getting used to calling it ECU. The French like the sound of it; hundreds of years ago they had a coin that was called an ecu.

The second difference vis-à-vis the previous "snake," which I already mentioned earlier, is that countries that join later will be able to do so with a large margin of ± 6 percent for their exchange rates. I cannot welcome that [provision], as I have already indicated, but it is a significant difference.

The third important difference is that this ECU system is a cocktail, a basket made up of the nine currencies, and the currencies are mixed into this cocktail at varying weights. This ECU system, in addition to the existing parity grid of exchange rates, will serve as an indicator for deviations. As I said earlier, however, this indicator does not trigger any obligation for intervention, but it can, for instance, trigger an obligation for consultation.

I think that two things experienced in the "snake" exchange-rate cooperation system will be reconfirmed in the larger circle of participants: First, that exchange-rate stability leads all participants in the national economy to greater trust in the stability of their own currency and monetary situations, to greater trust in the reliability of the calculability of business decisions, commercial decisions, and to greater trust in the ability to forecast the outcome of a business or

commercial operation that one joins today, but that first yields results in another two or three years.

Second, another thing experienced in the “snake” will also be reconfirmed here; namely, a greater solidarity among the participating countries.

Since I mentioned the “snake,” I also have to mention – I consider it important – that the heads of government of Belgium, Holland, the Federal Republic of Germany, Luxembourg, and Denmark determined yesterday that this “snake” will be maintained and will continue to function until the moment the new monetary system becomes operational. That is, they have declared that they are not considering any changes in their exchange rates. [. . .]

Source: “Europäisches Währungssystem, Regierungserklärung von Bundeskanzler Schmidt über die Ergebnisse des Europäischen Rates in Brüssel am 6. Dezember 1978” [“Policy Statement by Federal Chancellor Helmut Schmidt on the Results of the Session of the European Council in Brussels, December 6, 1978”], in *Bulletin* (Press und Information Office of the Federal Government), December 8, 1978, no. 146, pp. 1353-57.

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