The European Economic Community: Ethics and Monetary Policy in Luxembourg

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May I first of all express my gratitude to you Dr. Cernera, and to the members of the Board of Trustees and of the different faculties of Sacred Heart University for having invited me to deliver the Joseph Grau Memorial lecture this year. It is a great pleasure and a privilege for me to address such a select audience, in the presence of so many distinguished scholars, former colleagues of Professor Grau, and government and local authorities of Connecticut.

Believe me, I am deeply moved and delighted to receive the Sacred Heart medal from the hands of Dr. Cernera. This is a great honor which the institutions I am serving and the country I am coming from deserve more than I do. The Chamber of Commerce, the University Center of Luxembourg, and I personally will do our best to be worthy of this high distinction. I think, however, that it would have been more correct that Luxembourg would be granting such a medal to your University in recognition of the efforts of Professor Fairbaugh in launching in my country in 1991 a Sacred Heart MBA program focusing on the needs of the economy of the smallest European Community (EC) country, a country which was lacking post-graduate education opportunities.

Professor Grau devoted much of his research work to religious ethics. My research work at the Luxembourg University Center is focused on monetary theory. Thus in accepting Dr. Cernera's invitation to address this audience, I thought that, respecting the spirit of Professor Grau, I would start this lecture by looking more closely at ethics in monetary theory and further on in international relations with regard to the experience made by small countries like my own.

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As monetary systems depend on a choice, they also depend on a moral value judgment. They are not neutral: some people respect the rights of the individuals and the nations, whereas others violate these rights. This necessary relationship between monetary systems and ethics could have been one of Professor Grau's topics. There are in fact monetary systems in which money takes up its various functions in the strict respect of everybody's rights. Systems of that kind entail an international monetary discipline, while other monetary systems are causing speculation, unjustified enrichment, and deprivation. Professor Grau would have said that order or disorder, coherence or incoherence, fulfillment or disrespect of commitments may be looked upon as the ethical touchstone in the monetary field.

The most important merit of the fixed exchange rate system — and related systems such as the European Monetary System (EMS) — is the fact that it avoids establishing any difference between ethics in interstate relationships and ethics in interpersonal relationships. In the manner of the individual paying his debt by withdrawing cash, the debtor country honors its foreign debts by reducing its money supply; that is to say the debtor country renounces to obtain real assets and to live beyond its means. Like the individual who increases his liquid assets by the fruit of his work, the creditor country that recovers liquidity increases its wealth because with the help of international means of payment it enlarges its power to acquire real assets.

There is no doubt that the choice of a monetary system is closely related to ethical values. My country is also a product of ethical options taken by the political powers meeting at the Vienna Congress in 1815. Indeed, Luxembourg recovered its independence, lost in the fifteenth century, only at the beginning of the nineteenth century, in the light of a newly rising ethical theory, which says that nations should try to come to more balanced relations between each other by adopting the rule to solve their differences by negotiation rather than by war. It was in 1815 at the Congress of Vienna where the superpowers of the time tried to implement this ethical approach to organize a balanced Europe. Professor Grau would have been tempted to say that Luxembourg is a product of basic values of human relations applied to nations.

But ethics were hard to get into the minds of the nations. For a long time Luxembourg remained a mere object of international politics. The lack at the time of a real Luxembourg foreign policy and of an instrument to carry out such a policy led three times at least — in

1870/71, 1919, and 1939 — to a situation where Luxembourg's national existence was seriously threatened without Luxembourg having the possibility to intervene effectively with foreign powers or even to make its voice heard.

History shows us also that the recovery of Luxembourg's independence had a heavy price. Three times — at Congresses in 1659 in the Pyrenees, 1815 in Vienna, and 1839 in London — the country lost a very large part of its territory and its people. From a rather big country having produced four Holy Roman Emperors, Luxembourg was reduced to a small-sized country.

In order to be able to feel how weak an economy of a small sized country is, let me remind you first of the basic facts of Luxembourg's economic life. The main feature of Luxembourg is that domestic demand is insufficient as a result of the country's small size and limited population. This means that we must export national production of goods and services if only in order to attain the levels of production required for economic viability. Natural, human, and financial resources are not sufficient, in terms of either volume or variety, to meet the nation's requirements as expressed in the different components of economic demand. Hence the need to import.

The need for economic viability calls for economies of scale; in other words, we must attain an adequate level of production. The ``development pole'' theory of Francois Perroux dictates that in this case production will absorb most of the factors of production available, with the result that: first, there is a tendency towards specialization, and hence towards the concentration of production; second, in order to fill out the range of domestic factors of production, there is a proportionately greater reliance than in larger countries on foreign factors of production: labor, skill, technology, capital. In the absence of a sufficiently broad and self-sufficient domestic market, growth and employment depend to a large extent on increasing the value of exports. In other words, growth is, at least in part, export-led. These are the structural constraints which govern the workings of Luxembourg's macro-economic circuit.

The lesson drawn from this by the Luxembourg authorities and economic leaders is that Luxembourg is far less able than a larger country to rely on economic policies built around expansion. And in that case, Luxembourg must rely more on a structural policy aimed at

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establishing the legal, administrative, fiscal, and quasifiscal climate, together with the infrastructure, which will encourage the growth of supply.

The country is at the mercy, so to speak, of what goes on beyond its frontiers but can have no control over. The risk then arises that Luxembourg's trading partners may ignore the country's needs. This threat to Luxembourg's independence can always find its expression in a return to protectionism, which would inevitably hit Luxembourg harder than any other country, since it would cut the country off from virtually all its markets. Successive governments since 1839 have been aware of the need to meet two conditions in order to develop the Luxembourg economy: to open up the economy; and to attempt at the same time to join one or several larger economies in order to overcome the disadvantages of the small economy. Thus, Luxembourg joined the German Zollverein in 1842, and allied itself with Belgium in 1921 to form the Belgo-Luxembourg Economic Union (BLEU), took part in the foundation of the Benelux economic union after the Second World War, was a founding member of the United Nations and the General Agreements on Tariffs and Trade, and was a founding member of the European Coal and Steel Community (ECSC) and of the European Community.

In an article published on March 24, 1989 the historian Christian Calmes pointed out: ``It was on account of its economic structure that Luxembourg was able to become a founding member of the European Coal and Steel Community, and it was that which opened the door to the four treaties. Since then the economy has become the key not to independence (which is now a matter of fact) but to the country's survival, to the point that the collapse of the economy would result in the overthrow and disappearance of the entire community.'' That is to say, of Luxembourg.

The respect of the ethical rules in international relations is the only efficient guarantee allowing small countries to develop their economy. By accepting the economy of smaller countries to be integrated into their own economies without hurting the sovereignty, dignity, and identity of small countries, bigger countries behave according to ethics.

In the case of Luxembourg, history shows that in spite of initial reluctance due to the fear of the unknown the steps towards integration had always proved beneficial to the country. It was in fact the German Zollverein that laid down the conditions for the development of our formerly backward rural economy towards industrialization followed by the take-off of handicraft, banking, and trade. The dissolution of this customs union shows the economic problems the country had to face until the end of the Second World War.

Only after the accession to the ECSC and the European Economic Community (EEC) the country's economic growth rates progressively bounded forward and this impressive result generated an unprecedented increase of the citizen's living standard. Luxembourg's membership in the ECSC and the EEC even strengthened its autonomy and widened its range of decision-making, thus refuting certain people's fears related to an eventual loss of sovereignty. Moreover, Luxembourg's EEC membership provided the country with a greater latitude of acting within the BLEU and made it more resistant to the two powerful neighboring countries.

This statement can be backed up with facts. After the First World War, Luxembourg was threatened by economic strangulation in a protectionist environment characterizing the economic relationships between nations at that time. Thanks to the fact that Luxembourg handed over a part of its monetary sovereignty to Belgium it could acquire the financial instrument necessary to develop its foreign trade. Although not having been consulted in 1935 and 1982 when the Belgian franc was devalued, because Luxembourg was not represented in the Belgian Central Bank, the country was authorized by Belgium to make its currency a part of the European monetary system founded in 1978 in Bremen. Luxembourg also got the opportunity to be represented in the Committee bringing together the Governors of the Central Banks of those countries whose currency is a part of the European monetary system. In this case, the EC once more behaved according to ethical rules.

According to the economic and monetary union laid down in the Maastricht Treaty, Luxembourg will even have the privilege to be considered as a fully-fledged member having the same rights as the other member states insofar as the provisions of the treaty do not foresee a sovereignty transfer but a combination of different national sovereignties. Thus the provisions of the Maastricht Treaty, in reinforcing the monetary impact of every member state, Luxembourg included, are in conformity with ethics. The provisions concerning the economic and monetary union endowing Luxem-bourg with a stable currency are indeed very beneficial to our monetary sovereignty. They also maintain the country's possibilities to define its own legal framework concerning the taxation and social security systems and let Luxembourg adapt its economic policy to the country's specific needs and tradition of national consensus.

This particular issue was intensively discussed this year in Europe in the framework of the Maastricht Treaty under the headline ``subsidiarity.'' This is an idea which stems from Catholic social doctrine, and again has to do with ethics cherished by Professor Grau and, in this particular case, ethics in international relations. As I am more familiar with monetary and financial theory, I ask you to allow me to explain what subsidiarity means in terms of the provisions of the Maastricht Treaty.

But before doing this, I want to make a preliminary remark with a view on ethics. The Treaty of Maastricht is not to be mixed up with the Treaty of Rome, nor with the Single Act of 1985, which led to a Single Market in eight weeks time. The four freedoms (for persons, goods, services, and capital) are already enshrined in the Treaty of Rome of 1958. The freedom of capital movements, however, was not fully implemented in secondary legislation until 1988, with geographical exceptions running until 1995. Under this heading, secondary legislation concerning the harmonization of taxation on revenues from capital was raised unsuccessfully. The Treaty of Maastricht raises the principle of freedom of capital movements at Treaty level but does not refer anymore to a European taxation under this chapter.

The Treaty of Maastricht is also not to be mixed up with the freedom of services and the Single Market, which implied a considerable number of harmonized regulations in order to achieve mutual recognition of residual standards of regulation among EC countries. Most of these regulations were, however, either preceded or backed up at international level in Basel. In the coming days and weeks Luxembourg will have completely enacted all relevant texts concerning financial services for the purpose of the entry into force of the Single Market by the first of January 1993.

Luxembourg is therefore well ahead of many other countries in Europe, but especially outside the EEC. Operators in Luxembourg will act in a regulatory environment that will set the standards beyond the EEC. A high standard regulatory environment and national prudential supervision are the best requisite of preventing money laundering and thus keeping the Luxembourg banking center in conformity with ethics. In this respect the Treaty of Maastricht confirms national competence in prudential supervision, since the European Central Bank can only achieve a mandate in this field by a unanimous decision.

Economic union is a perfect example of the subsidiarity principle under both its macroeconomic policy leg and its fiscal balance leg. A single macroeconomic policy at Community level is not foreseen. National policies are to be coordinated. They shall conform to broad guidelines established at the highest political level. No legally binding constraints are foreseen, only political recommendations. These legally binding constraints are, however, foreseen in the second leg of economic union, the public deficit procedure, since the financing of these deficits has a direct bearing on monetary policy. But the EC competence is limited to what is relevant to monetary policy, i.e. the budget balance. How this balance is achieved remains a national competence. The details of public expenditure as well as the details of public revenue are determined by national authorities.

The picture is quite different for monetary union where there is a transfer of exclusive competence at Union level at least at a decision-making level. Subsidiarity applies here insofar as execution of decisions shall be implemented through national central banks. For a country which yielded its monetary sovereignty to another small monetary authority without participating in its management, to achieve equally shared sovereignty in one of what will be the strongest currencies of the world seems to be a considerable asset for a financial center which through Maastricht finally acquires a lender of last resort. Professor Grau would have valued such a provision as economic justice for a small country!

Ethics also play an important part in national relations. In an interview published on April 2nd, 1989 in the *New York Times*, Professor Grau answered Sharon L. Bass's question ``How does the idea of integrating ethics with business work?" by noting the following: ``Ethics say people should work together to improve the quality of work life so that you can fight discrimination, for instance. Workers should be treated like worthwhile human beings and not as cogs in a machine." In Luxembourg, we operate a very moderate system of workers' participation in some aspects of management. This system, which promotes responsibility among wage earners, gives them a say in some matters relating to security and health problems, but leaves management decisions where they belong, and that is with management. Experience in Luxembourg has shown that this system, which is a sound compromise, has on the whole been beneficial.

Indeed the system brought Luxembourg the reputation of a solid tradition of industrial and social peace, which is basically grounded on ethics. Social problems are dealt with under a broad system of negotiation and conciliation between labor and management at both company and national levels. These arrangements have enabled Luxembourg to remain free from major strikes since 1921. For the last fifteen years the conciliation procedure has been given even greater strength as a result of a tripartite conference in which government, employers, and trade unions are all represented. Social peace is also the prerequisite of governmental stability. All Governments of whatsoever political color since 1944 stayed in office for a full five-year term.

In April this year, during a Convocation ceremony here in Fairfield, H.R.H. Crown Prince Henri of Luxembourg, on the occasion of being granted an honorary degree of Doctor of Humane Letters by Sacred Heart University, told the audience that Luxembourg was able to attract foreign, mainly American, investment and thus developed into an industrial, an international communication, and an international financial center, thus providing Luxembourg with a balanced economic structure. There is no doubt about the fact that the implementation of ethics in international relations between nations laid down the foundations of this successful development. But if ethical behavior in interstate relations is necessary, it is not sufficient to explain the economic progress of Luxembourg. Luxembourg had also to respect ethical values in national relations. Luxembourg generated a business-friendly climate towards investment by keeping overall costs lower in terms of taxes and contributions of the social security institutions than in neighboring countries. But most important is probably the fact that our general approach towards foreign investment is one of particular attention to each project. Contact with whomever is competent in Luxembourg to make decisions is easy. The administration in Luxembourg is small and uncomplicated. A team of red-tape cutters is readily available and will assist any project from the earliest stages to its completion and even beyond.

For instance, the structural policy to which I just referred is associated with a social policy of redistribution, the aim of which is to maintain social cohesion and consensus as the necessary conditions for sustaining and improving the productivity of the Luxembourg economy. We have seen this morning that the Maastricht Treaty allows Luxembourg to continue this policy of economic development because, in opposition to what is commonly believed in Japan and in the United States, each member country of the EC continues to bear the responsibility of its economic and social policy. But may I once more point out that although this approach is necessary to guarantee further growth of the economy of small countries, it is not sufficient. One leg is missing: ethics.

The explosive growth of the financial institutions in my country became possible only because the Luxembourg authorities were anxious to preserve the good name of Luxembourg and to take care to encourage only banks of sound reputation. In addition, Parliament set up a very serious but pragmatic supervision authority which takes care of the two hundred banks established in Luxembourg. The authorities are keenly aware of the necessity of preventing malpractices. The most strict law in the world in punishing money laundering from drug revenues has been passed by Parliament in 1989. The banks have responded by adopting high standards of conduct, such as the system of self-regulation introduced in January 1989 to prevent money laundering. These regulations go ahead with strict banking secrecy rules enshrined in a reinforced law on the banking secrecy. I am sure that Professor Grau, who constantly was evaluating business activities against the background of ethics, would have approved of the Luxembourg approach to international financial activities.

A small country which owes its existence to a recent change of mentality towards ethics in international relations must not only stick to ethical rules in home affairs, but has also the moral obligation to use its voice against disequilibrium in world affairs. Professor Grau believed that disequilibrium of benefits could only serve to undermine the health and well-being of multilateral trading systems and handicap developing countries. That is the reason why in my country's endeavor to bring the General Agreement on Tariffs and Trade (GATT) negotiations to a balanced conclusion, Luxembourg will not expect from developing countries the acceptance of obligations which are incompatible with their level of development. However, Luxembourg expects from more advanced countries that they gradually integrate themselves into the open multilateral system and accept more obligations compatible with their level of development. This seems to me to be in line with Professor Grau's thinking.

Ethics are also related to EC-Europe's responsibility in the next years towards countries in Eastern Europe. A major upheaval in Central and Eastern Europe has swept away the Communist system and freed its peoples from the shackles of totalitarian government. Democracy and free enterprise burst open and flourish after having been repressed for decades. But, at the same time, darker forces which had also been hidden under thick layers of authoritarian rule and massive propaganda are now erupting all over the eastern part of the continent, threatening to engulf the freshly freed peoples in chaos and bloodshed. The events in Serbia and Bosnia-Herzegovina do take us back to a pre-World War situation characterized by raw nationalism and fratricidal conflicts. In this context, I would like to quote Luxembourg's Prime Minister's ethical view on the subject. He said:

> Today, the peoples of the now prosperous and confident European Community must be generous towards their Eastern brothers and actively help them to overcome the demons of the past and to channel their energies and skills into one of the most stimulating and successful ventures of our century.
>
> After having consistently advocated in words and deeds the principles of democracy and the free market, the Community, together with its Western partners, must now live up to its promises and rise to its historical task.

This challenge seems not so easy to cope with, as many

Europeans, spoiled by a generous system of social security and high salaries, become more and more selfish. A growing movement of refusal to accept the price and the burden to help people in Eastern countries to survive and to welcome at home refugees is a sign that too many EC citizens are lacking in basic moral values.

Professor Grau was looking at what was happening in the world and evaluated it against the background of what he called ``theological humanism.'' Basically it is how we can improve the world through ethics. It has to do with a way of thinking about what is good and evil. Small countries perhaps do not have the choice of an other non-ethical approach. Some scholars advocate that this is also the reason why my country behaves in the spirit of ethical values.

In my view, however, such a behavior primarily is grounded on education based on fundamental Christian values. Sacred Heart University should be proud of having had among its scholars such an outstanding but modest teacher as Professor Grau. Did he not say in interviews ``I am hoping to help those who are struggling in very difficult situations to deepen their commitment to living out a life that will help towards a more just and humane society''? In offering in Luxembourg postgraduate continuing programs inspired by Christian ethics, Sacred Heart University honors Professor Joseph Grau's memory and helps Luxembourg to respect ethics.

Luxembourg should be grateful for all this.