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Ref./Comments: Draft outline of the report of the Committee for the study of economic and monetary union.

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22nd July 1988

Dear Tommaso, Jean-Paul, Joly,

Please find attached an attempt to concoct a skelleton outline of the report of the Delors Committee. As you can see from my annotations, I had considerable difficulties in setting out the most important part (i.e. Section V dealing with concrete steps), mainly because of two reasons. Firstly, there is the thorny question of a balanced progress in all major policy areas. On the one hand, I can imagine that some Committee members will place great emphasis on a parallel integration in monetary and non-monetary areas. On the other hand, I am afraid that the Committee is not sufficiently competent to make clear and detailed recommendations in the non-monetary areas and, more importantly, it would be extremely difficult to draw up an action plan which would specify step-by-step measures to be taken simultaneously in both the monetary and non-monetary fields. Secondly, there is the problem of too many alternative routes towards monetary union. A detailed analysis of various approaches would make the report too academic and confusing and would probably be counterproductive. I feel that these two issues should be taken up by the Committee as soon as possible. As far as the other sections are concerned, I think it should not be too difficult to draft them and we should in fact try to have a first version of them ready by November 1988.

Of course, this draft outline is only a first attempt and I am certain that you can improve on it. In particular, if we want to distribute an outline at the end of the September meeting (or shortly thereafter), we will need a much less annotated version and preferably one which allows for a certain flexibility. You will of course notice that I have not made special reference to the Chairman's questions. If he wishes to see them repeated in the outline, they would have to be incorporated in Section V.

Let me turn briefly to the paper on experience with and lessons from the Werner Plan. I take it that the three notes we received in Brussels will be combined into one paper. As far as I can see, the three notes contain all the major points and it remains therefore mainly a drafting task to produce a single paper. However, with a view to the future work of the Committee, I think it would be most useful that in amalgamating the three notes special consideration could be given to the question of whether the Werner Plan foundered because of external factors or because of excessive constraints, which would have resulted in a break-up of the exchange rate arrangement even under less unfavourable external circumstances. Moreover, it might be useful to contrast briefly the experience under the Werner Plan with that of the EMS.

With best wishes for the summer holidays and best regards.

Gunter D. Baer

22nd July 1988

Principle elements of an outline of the report of the Committee for the study of economic and monetary union

I. Definition of economic and monetary union (EMU)

This definition would serve as a point of reference of what is to be ultimately achieved. The Werner report sets out clearly the essential elements of EMU and all of what is said in this respect in the report appears to remain valid today and could provide a benchmark against which concrete steps towards EMU could be gauged.

II. Implications of EMU

This part should specify as clearly as possible the minimum requirements which have to be met for making EMU operational. In particular, it should examine the degree of integration that would have to exist in the final stage in the various areas of economic policy-making, the extent to which decision-making would have to be elevated to the Community level (involving a transfer of national sovereignty), and the necessary institutional (and legal) changes.

III. The state of integration in the Community

This section should present a stock-taking of achievements until today. It should stress not only factual achievements and the more formal aspects of progress (i.e. advancements in institutional arrangements and procedures in various areas, most notably in the monetary field) but also the informal aspects (i.e. the convergence of views on policy objectives and the willingness to co-operate more closely than would have been necessary if member countries had interpreted existing agreements more restrictively). What I have in mind is that, for instance, the success in monetary co-operation cannot be attributed simply to technical constraints imposed by the exchange rate mechanism, but was also the result of a remarkable readiness to find mutually agreeable solutions in a climate of converging policy priorities. This point is important because it applies also to those EC countries that have not yet accepted (or not fully accepted) certain formal obligations.

This section might end with an evaluation of the achievements made so far. However, rather than presenting a kind of cost/benefit analysis, the appraisal should emphasise the irreversibility of the process of integration and point out that any step backwards or even stagnation could entail immense economic and political costs. In fact, it might be argued that risks of a setback could become greater if the momentum of integration is not kept up.

IV. The challenge of 1992

This section should sum up the measures which have been agreed in principle and are expected to be implemented by 1992. In addition, it should make clear that the creation of a single market would take the Community far beyond the stage one envisioned under the Werner Plan. This conclusion will then probably have to be followed by a discussion of whether or not the implementation of a single market necessitates complementary measures in other fields, the most important obviously being monetary policy. While the Committee may not come to a consensus view that further steps (of a more fundamental nature) are absolutely necessary, agreement may possibly be reached that further steps are highly desirable before the single market is completed.

V. Concrete steps towards EMU

This is of course the hard core of the report and the structure of this section will depend to some extent on the concept for integration favoured by the Committee. For this reason it might be helpful to start with an introductory sub-section on the type of approach advocated by the Committee.

(a) Conceptional issues

This sub-section will have to answer a number of questions:

- is it necessary to work out a comprehensive global scheme or would it be better to follow a more pragmatic approach which builds on the completion of a limited number of concrete steps? This question can also be rephrased as follows: is it necessary to lay down precisely all the steps which lead to the final objective or would it be better to maintain some degree of flexibility by specifying measures to be taken during the first and perhaps the second stage, but leaving open what needs to be done in subsequent periods?
- should the process of integration rely on the use of "mechanisms" (i.e. formal constraints limiting directly national autonomy) or more on voluntary co-operation?
- to what extent is it necessary to make simultaneous progress in all major areas of economic policy-making?

If the Committee aims at a very comprehensive action plan leading the Community to full EMU at a specific date, this section would probably have to provide a detailed account of each step taken pari passu <u>in all major policy areas</u>.

This would be a virtually unmanageable task, and be presumably beyond the competence of Committee members. Moreover, it would probably result in a totally unreadable and unrealistic report. In order to avoid this kind of report, the Committee, while recognising the need for complementary measures in non-monetary fields, could stress its comparative advantage in monetary matters and focus its work on laying down concrete steps towards monetary union. In doing so it could be emphasised that there exists a close relationship between progress in the monetary and the non-monetary field and that the timetable on implementing the recommended steps towards monetary union is contingent upon adequate progress in other areas.

This would allow to deal "once and for all" and in a somewhat more general manner with steps required in the non-monetary area. Consequently, sub-sections (b) and (c) could be:

(b) Fiscal and budgetary policies

This sub-section would explain the degree of harmonisation needed in fiscal and budgetary policies and the extent to which national independence could be maintained; it would also investigate the effects of budgetary policies on financial markets and take up the question of transfer payments.

(c) Other major policy areas

This sub-section should sum up the main issues in the fields of regional, competition, social and income policies and comment briefly on the measures needed to reach the minimum degree of integration compatible with EMU (as discussed in Section II).

(d) Monetary policy

The structure of this part will be determined largely by the ability of the Committee to come to a consensus view on the most desirable approach. If there is one commonly accepted approach, this part could simply state if, detailing step by step the recommended measures. If, however, there is no agreement, alternative approaches might have to be discussed. In order to "generate" as much agreement as possible, this part might start out by recalling the change in environment that will take place in the context of creating a single market. At least in terms of analysis of the implications of these changes for monetary policy (basically that there can be only one monetary policy) there should be no disagreement in the Committee. But that does not mean that views will not differ on how to come to one monetary policy and different models for European monetary integration might therefore have to be discussed. For example, in their order of stringency (or degree of "qualitative jumps") this part might describe:

- progressive narrowing of margins of fluctuations between Community currencies (along the lines of the Werner Plan) to a point where parities can be irreversibly fixed and margins of fluctuation be eliminated;

- introduction of a parallel currency, either in the form of the present ECU (i.e. a standard basked) or in the form of a new standard (called ECU but defined in "its own right" and not as a weighted average of Community currencies);
- a new single currency replacing existing Community currencies.

Obviously the three (or four) approaches have distinctly different implications (institutional and for the conduct of monetary policy). If those were fully spelled out it would result in a lengthy analysis of a certain academic value but of little practical relevance. Under all circumstances this description of alternative models (if it is necessary at all) has to be short (simply to show that the Committee has done its homework!) and be followed by - at best - two main courses for action. I could imagine that one course would be the "co-ordination-cum-gradual transfer-of-power-approach" compatible with growing exchange rate stability and the other course would be the use of a new standard as a parallel currency.

If it were possible to confine the options to two, the remainder of this part of the report would be rather straightforward:

- detailed description of the approaches;
- detailed description of the institutional and legal implications, including a discussion of the transfer of national autonomy to the Community level;
- breakdown of the approaches into individual steps which could be undertaken at specific stages, ending with full monetary union.