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The Governor

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Dr Gunter Baer
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Dear Gunter,

I have already let you have, in my letter of 15 March, a list of my proposed amendments to Part III of the Draft Report of the Committee in the hope that you might find them helpful in your work of redrafting the Report following our discussion earlier this week. I am writing now to let you have some further proposals, covering the drafting of Part I and Part II, with the intention of bringing greater precision to a number of points, as well as reducing the overall length of the draft. There are also some additional points that I should like to make on Part III, arising out of our last discussion. In putting these proposals forward, I am conscious of the difficulties that you, as Rapporteurs, inevitably face in ensuring a balanced reflection of the wide range of views expressed in a Committee such as ours. I believe, however, that we have now reached a position where we can agree on a short and clearer version of what we wish to say.

I think that it was the sense of our meeting last Tuesday that the first part of the Report needed to be very much shorter. In particular, there was little support for a lengthy exposition of the achievements of the recent past, and several of us disagreed that completion of the internal market in itself made early, institutional progress towards economic and monetary union necessary. I very much support Pierre Jaans' suggestion that it would be better to omit paragraphs 6 to 18 completely. There are

even then one or two drafting points which I hope you will be able to accept as constructive suggestions and I attach these in a separate Annex.

You already have to hand, of course, the earlier draft structure of Part II which I circulated at our February meeting. The essential elements in that structure, to which I still attach considerable importance, were as follows:

- (i) dropping any reference to Treaty change from the introduction and keeping subsequent reference to Treaty change in Part II to a minimum, cross-referencing it to a further examination in the context of the concrete stages in Part III;
- (ii) introducing the concepts of hard and soft EMU, on the lines proposed in October by Karl Otto Pöhl;
- (iii) cutting down the detailed prescription of institutional requirements and political relationships currently contained in Section 4;
- (iv) separating into two Sections, (which would become 3 and a new section 4), the treatment of economic union per se and economic union with a single currency;
- (v) dealing with fiscal transfers in the context of a premature movement to hard economic union;
- (vi) less emphasis on the idea of a long period of fixed exchange rates before a single currency is introduced;

Naturally, my first preference would be for Part II to follow the lines indicated in that outline. I recognise, however, that we have been invited to submit comments on the text as it stands. The proposed amendments in the attached annex therefore suggest ways in which the drafting of the current text could, I believe, help us to reach common ground.

Finally, at our last meeting, Dr Lamfalussy and Dr Duisenberg circulated two texts covering the possibility of Treaty change, on which we were invited to comment. I have attempted to suggest drafting changes to Dr Lamfalussy's text (building on Dr Hoffmeyer's amendments) that indicate my areas of concern. I may have further minor comments on Dr Duisenberg's draft in due course, but I am content to leave that for our meeting.

Yours sincerely,
H. Heich-Pemberton

FOREWORD AND PART I

I find the first draft of Part I too long for the balance of the report. Jaans has put the points well in his letter and we would support his proposal to eliminate paragraphs 6-18 as a preferred way forward. The following comments might be helpful, however, on the other paragraphs of this draft text.

Foreword

- (i) Para 3: Suggest that last two sentences should be omitted. Alternatively, they should be made conditional and "is firmly convinced" should read "believes". ✓
- (ii) Last 2 lines of para 5: "... third indicates the kind of concrete steps which might be taken to enable the Community to progress in stages towards economic and monetary union". ✓

Part I

- (iii) Para 2 line 8: "... indicates that the Community is tackling the ...". ✓
- (iv) Paras 6-18 could, in my view, be omitted. If section 3 were to be retained in some form (possibly in section 4 of Part I), I would prefer to see it shortened and the message altered to make it clear that the single market does not require EMU or a single currency. I would also like to see somewhere the argument that single market integration needs to be fully digested before the implementation of major institutional steps towards economic and monetary union. ✓
- (v) Para 9 page 6: I do not believe that the Community has endorsed the objectives in lines 3 and 4. In my view they would be better omitted, as would the reference to "... strengthening the scientific and technological foundations of European industry ...", which is presumably an allusion to the concept of a European Research Programme, which remains controversial.

- (vi) Paras 10 and 11 (pages 6-8): This section assumes that the Community will, by the end of 1992, be a fully integrated market and that the resulting instabilities and inequalities will need to be the subject of urgent Community action beyond a point where voluntary co-operation will suffice. I would like to see the language here altered to note the fact that Member States will take many years to digest the volume of single market legislation, as will their economic structures. I would also like the report to reflect the view of many of us that the Community should not be taking any major institutional leaps until the process of digestion is further advanced. It might be noted in this connection that the process of integration will lead to pressures for increasing co-ordination, some of which may properly be led from the centre. In detail, suggest in para 11, sub-paragraph 2, line 14 text should read "... thus necessitates greater co-ordination ...". In sub-para 3, delete second sentence. *deleted*
- (vii) Para 12: It is not unanimously accepted that the success of the internal market programme hinges "... to a decisive extent ..." (emphasis added) on a much closer co-ordination of national economic policies. Moreover, while "serious consideration should be given to the limits of voluntary co-ordination ..." as progress is made towards economic and monetary union, in my view these limits will not be reached with the full implementation of the internal market programme. ✓
- (viii) Para 13 line 10: "promote" for "guarantee". Omit "strongly" in line 13. *deleted*
- (ix) The points in paragraph 14 are assertions whose validity would not be unanimously accepted. Moreover, in this context, they are not relevant to the Committee's mandate. The paragraph might therefore better be omitted. *deleted*
- (x) Para 15: First sentence would benefit from a reference to price stability as well as growth and employment. *deleted*

(xi) I should prefer to see the first sentence of para 16 recast to avoid the implication that EMU is necessary for the completion of the internal market. Perhaps the text could read "... EMU established in the right conditions could enhance the efficient working of the single market."

(xii) Para 18: Omit second sentence "... The full implementation and the success of the single market, by itself, requires an increased degree of economic policy co-ordination even in areas that are not, as such, part of the internal market programme ...", which expresses a view that is not universally held in the Committee.

PART II

Section 1: General considerations

In general, Part II of the Report seems to me to be a little long. This might be helped by some redrafting. I think that it is important that the hard decisions which will be faced by Heads of State and Government in taking concrete steps towards economic and monetary union should stand out clearly.

Two suggestions in paragraph 20:

- (i) final sentence contains an important point for many members of the Committee. Notwithstanding my general preference for brevity, this is one point that I believe deserves fuller treatment;
- (ii) perhaps a more appropriate place for this argument, however, would be at the end of Part II as the culmination of a logical sequence of argument. This should demonstrate to the European Council the context within which any remarks on the need for Treaty amendment are made.

P.13: Third sub-paragraph of paragraph 21, could be omitted. The arguments that it contains are of course important but they are more fully explored later in the draft. If retained, it would be better to make clear that convergence should be on best, rather than average, public sector performance.

Section 2: The principal features of monetary union

P.14, Paragraph 23: The principle of parallelism and the relationship between economic and monetary union has been central to much of the Committee's discussion. Some members have expressed the view that monetary union must be seen in the context of economic and monetary union. There is therefore a good case

for suggesting that the order of argument should be from economic union through monetary union to economic and monetary union. Suggest therefore that Section on economic union should precede that on monetary union.

P.14, Paragraph 23, 3rd sub-paragraph: Difficulties described here are real but difficulties of maintaining a long transitional period may be even greater. This point could be emphasised. I would prefer the paragraph to conclude in favour of a transitional period as short as possible, once the final decision to move to the irrevocable locking of parities has been taken.

P.15, Paragraph 24: No need at this stage to describe future of ECU in such detail. While the principle could be referred to, the detail should be left to Part III.

Two points on page 16:

- (i) the Report does not explore extent to which even a federal European System of Central Banks could be constructed in different ways. While one model might have its own balance sheet, this is not indispensable; and I would like the draft to make this clear. In the final sentence of the first paragraph on p.16, it is not clear what it meant by "instruments" that would have to be developed. Does this refer to institutions or market instruments?
- (ii) Second paragraph on page 16 also needs to address questions of external exchange rate policy. Will EMU exist in a fixed or floating relationship with eq US dollar? Second, and even more important consideration: need to emphasise here that not all weight must be placed on monetary policy. Co-ordination of budgetary and fiscal policies will have an important role to play and this needs to be made clear, though not in detail, even at this point.

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take care of it previous

P.17, Paragraph 26, final sentence: See previous remark. Might be more helpful to treat this important issue rather earlier and at more length.

P.17, Paragraph 27, third indent: Suggest: "possible need for common policies ...".

P.18, Second Paragraph: Suggest a redraft that makes clear that a common monetary policy and a single currency area are not necessary for economic union, even though they may be desirable.

P. 18, Paragraph 28 could usefully be expanded to give greater detail on the concept of "soft" union, which goes beyond the single market as described here. The effect of this paragraph is to imply that the single market will be a fait accompli by the end of 1992 in all respects and that the next, inevitable step is to full economic and monetary union. I do not believe that all members of the Committee accept this implication. The Report should therefore make clear that there is a very great deal that could be done, consistent with a long-term goal of economic and monetary union, that goes beyond the completion of the legislative framework of the internal market.

P.18, Paragraph 28, line 8: Suggest: "Moreover, differences in national tax treatment may have been reduced to avoid ...".

P.19, Paragraph 29 could begin a new Section headed Economic and Monetary Union.

Third sub-paragraph of Paragraph 29: Suggest adding "among Community currencies" to the first sentence to make it clear that what is referred to is internal exchange rate realignments.

Fourth sub-paragraph of Paragraph 29: In line with the foregoing comment, I suggest the following drafting changes in the first sentence. "With parities irrevocably fixed within the Community, foreign exchange markets pressure for national policy corrections when national economic disequilibria developed ...".

I find the argument in the rest of this paragraph a little difficult to follow. Within an economic and monetary union the market would finance what would previously have been regarded as

balance of payment deficits without the need for official intervention. Moreover, the market will provide the appropriate adjustment pressures. It is not at all clear, therefore, that balance of payment imbalances "... would have to be detected and eliminated rather quickly ...".

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closed

Page 20

The argument here might be strengthened by making it clear that many of the difficulties described will arise acutely only if the Community attempts to progress towards economic and monetary union when the underlying divergences of economic performance remain excessive. In short, the sooner the anticipated move to EMU, the greater the need to consider the budgetary and political consequences. Conversely, of course, the more difficult the process of economic convergence and the more troublesome the associated political and social considerations, the more careful we should be about a rapid move to EMU. It would also be helpful to make clear that not all members of the Committee, including some of those whose regions might be expected to benefit, regard resource transfers as a solution to these difficulties. Finally, when we say (para 3?) that "effective" policies must be devised by the Community, the European Council should also be told that there are no easy options and that experience to date, both within nation states and within the Community as a whole, does not offer any reassurance that such policies would be effective.

Consistent with these points, suggest that first full sentence on page 21 should be redrafted to read "If exchange rates were locked at an early stage in the development of a single market, some major regional disparities would still persist, reflecting ill-adapted structures and differences in productivity."

is moved

Suggested redraft: of third sentence on page 21 "... especially if they were at the geographical periphery of the Community, to the highly developed areas at its centre. If economic and monetary union were to be undertaken before the disparities were reduced, to avoid undue economic and political tensions arising from possible dislocations of industries and labour forces, the Community would have to encourage and guide ...".

reworded

P.21, Second Paragraph: This paragraph could also make clear the continuing role that national regional policy will play, even within economic and monetary union. Not everything will have to be done by the centre and much might be better done within the regions. Suggest final sentence should be redrafted to read "... such policies might have to be strengthened further after 1993, depending upon the speed of progress towards economic and monetary union." *John, ok*

P.21, Third Paragraph: Suggest that the whole of this paragraph and the first full paragraph on page 22 could be omitted, in the interests of shortening the draft. *John*

P.22, Second Paragraph: Suggested redraft: "If wage flexibility and labour mobility are insufficient to eliminate differences in competitiveness in different regions and countries of the Community, there could be relatively large declines in output ...". At a minimum, the thought contained in the first sentence of this paragraph should be conveyed in both its positive and negative forms. *Accepted*

Paragraph 33: Suggest omitting bottom of Page 22 and whole of Page 23. The argument is well expressed in the final sub-paragraph on Page 24 and does not perhaps need such lengthy treatment. *John*

Some of the arguments in the second paragraph on Page 24 are the expression of one view, which I for one do not accept. The concept of "gearing wages policies largely to improvements in productivity ..." though superficially attractive, lacks a strong economic rationale. Moreover, the notions of "social partners" and "wage policies" connote a more interventionist stance than would be accepted by most Member States. The final sentence goes some way towards acknowledging that these ideas are not universally accepted, but suggest it would be better to omit whole paragraph. *Checked*

P.24, Third Paragraph: Redraft: Suggest we should insert (line 9) "... and other forms of monetary financing ..." after "central bank credit". *ok*

Paragraph 34: Redraft: "... the establishment of economic and monetary union would require ...". No

P.25: Omit first two indents. These are not agreed Community policies and remain controversial. Moreover, phrases such as "consideration of the social dimension of the European Community" risk sounding like sloganeering. No

4 Institutional arrangements

P.26, Paragraph 35: Omit "therefore": the arguments have not yet been made. Yes

A single monetary policy can be implemented independently, though it is arguable that it might be more desirable for it to be decided centrally.

P.26, Line 2: Redraft: "Monetary policy could be organised according to some federal form that might be called a European System of Central Banks." ok

Mandate and functions (P.26)

Redraft final function to read "the System would be committed to promoting price stability as a basis for sustainable economic growth." No

P.27: Suggest omission of first three indents: if this detail is necessary at all, it would be better placed in Part III. No

Policy instruments

Unnecessary to specify in statutes the instruments available to the system. Nor is it clear why ECSB should need authority to conduct central banking operations in money and foreign exchange markets. No

P.28: Final indent: There is no commitment to harmonised tax rates and it is not at all clear what institution is supposed to No

be recommending "... discretionary changes in Community resources ...". This is a fundamental question and should either be omitted or treated more fully.

Community policies in regional and structural field

Redraft last sentence to read: "... these mechanisms might have to be further extended and made more effective, depending upon the speed of progress towards economic and monetary union."

*ok
take care
M*

Macro-economic policy

P.30, first indent: Make clear that this refers not to the budget of the Community, but to the aggregate budgetary position of Member States, taken together. ✓

Section 5: Economic and monetary union in the context of the world economy

Omit paragraphs 39 to 43, which risk sounding self-serving in their assertion of Commission competence. The questions that are addressed here could be dealt with by Heads of State and Government at a later stage.

RE-DRAFT OF LAMFALUSSY/HOFFMEYER TEXT

47 Calendar. The conditions for moving from stage to stage cannot be defined precisely in advance; nor is it possible to foresee today when these conditions will be realised. The setting of explicit deadlines is therefore not advisable. This observation applies to the passage from stage one to stage two and, most importantly, to the move to irrevocably fixed exchange rates. The timing of both moves would have to be decided in the light of the experience of the preceding stage by the Council, the Commission and the European system of central banks, which would have been created in the second stage.

4 On the other hand, a clear political commitment to the final stage, as described in Part II of the Report, would lend credibility to the intention that the measures which constitute stage one should represent not just a useful end in themselves but a firm first step on the road towards economic and monetary union. The clearest demonstration of such a political commitment would be the co-ordinated implementation of economic policy measures in each Member State to secure price stability and convergence of economic performance within the existing institutional framework and the full participation of all Member States in the exchange rate mechanism of the EMS. Given that background a commitment by the political authorities, in good time before entering stage two, to enter into the negotiation of a new Treaty would have added significance.