pars I

11

14, 15, 16

42

COMMITTEE FOR THE STUDY OF
ECONOMIC AND MONETARY UNION

CSEMU/14/89
23rd March 1989
Draft

REPORT ON
ECONOMIC AND MONETARY
UNION IN THE EUROPEAN COMMUNITY

This report has been prepared in response to the mandate of the European Council "to study and propose concrete stages leading towards economic and monetary union".

Tina

ECU instead of ecu

Foreword

At its meeting in Hanover on 27th-28th June 1988 the European Council recalled "that, in adopting the Single Act, the Member States of the Community confirmed the objective of progressive realisation of economic and monetary union". The Heads of State and Government therefore decided to examine at the European Council meeting in Madrid in June 1989 the means of achieving this union. To that end they decided to entrust to a Committee, chaired by Mr. Jacques Delors, President of the European Commission, "the task of studying and proposing concrete stages leading towards this union".

In response to this request by the Heads of State and Government, the Committee has the honour to submit the attached Report. The ideas expressed and the proposals contained in the Report are given on the personal responsibility of the members of the Committee.

Table of contents

I. **<u>Past and present developments in economic and monetary integration in the Community</u>**

a halt

1. <u>The objective of economic and monetary union</u>

1. Efforts in the Community to progress towards full economic and monetary integration began ~~in earnest~~ as the Bretton-Woods system was ~~breaking up. The Werner Report on the realisation by stages of economic and monetary union was drawn up in 1970.~~ This initiative took place against the background of the major achievements by the Community in the 1960s: the early completion of the transition period leading to customs union, the setting up of the common agricultural policy and the creation of a system of own resources. The Werner Report, prepared in 1970, presented a first attempt to define and set out a plan for the attainment of economic and monetary union. In March 1971, following the Werner Report, member states expressed "their political will to establish an economic and monetary union".

showing signs of decline.

In 1969 the Heads of States and Governments, meeting in The Hague, agreed that a plan by stages should be drawn up with a view to the creation of an economic and monetary union.

2. Several important moves followed ~~the~~ at conclusion ~~of 1971~~: in 1972 the "Snake" was created; in 1973 the European Monetary Co-operation Fund (EMCF) was set up; and in 1974 the Council Decision on the attainment of a high degree of convergence in the Community and the Directive on stability, growth and full employment were adopted. Yet, by the mid-1970s the process of integration had lost momentum under ~~the~~ pressure from ~~the~~ divergent policy reactions to the economic shocks occurring at the time.

3. In 1979 the process of monetary integration was relaunched with the creation of the <u>European Monetary System</u> (EMS) and the ~~ecu~~. The success of the <u>EMS</u> in promoting its objectives of internal and external monetary stability has contributed in recent years to further progress, as reflected in the adoption, in 1985, of the internal market programme and the signing of the Single European Act.

~~(Para. 5) Pöhl suggests to write ECU instead of ecu.~~

European Currency Unit (ECU).

2. The European Monetary System and the ~~EMU~~ Ecu

4. The European Monetary System was created by a Resolution of the European Council followed by a Decision of the Council of Ministers and an Agreement between the participating central banks.

5. Within the framework of the EMS the participants in the Exchange Rate Mechanism (ERM) have succeeded in creating a zone of increasing monetary stability ~~while~~ at the same time as gradually relaxing capital controls. The exchange rate constraint has greatly helped the participating countries with relatively high rates of inflation in gearing their monetary policy towards the objective of price stability, thereby laying the foundations for both a converging price performance at a low rate of inflation and the attainment of a high degree of exchange rate stability. This, in turn, has promoted ~~a~~ e moderation in cost increases in many countries and led to an improvement in ~~the~~ overall economic performance. Moreover, ~~the~~ reduced uncertainty about exchange rate developments and the fact that the parities of the participating currencies ~~were not~~ have not been allowed to depart significantly from the fundamental economic factors have ~~[facilitated intra-European trade at times of severe economic difficulties and high unemployment]~~.

The EMS has served as the focal point for improved monetary policy co-ordination and has provided a basis for multilateral surveillance within the Community. Its success ~~is~~ can be in part attributab~~le~~ to the willingness of participants ~~countries~~ to opt for a strong currency ~~policy~~ stance, ~~but~~ also ~~to~~ the flexible and pragmatic way in which the System has been managed, ~~especially by the~~ with increasingly close co-operation among central banks. [The System has also benefited from the role assumed by the Deutsche Mark as an "anchor" for participants' monetary and intervention policies.] The EMS has evolved in response to changes in the economic and financial environment and on two occasions (Palermo 1986 and Basle/Nyborg 1987) its mechanisms have been ~~amended~~ extended and ~~improved~~ strengthened.

important has been

At the same time, the EMS has also suffered from a number of weaknesses. The lack of convergence of fiscal policies as reflected in large and persistent budget deficits in certain countries has remained a source of tensions and has put a disproportionate burden on monetary policy. Moreover, a number of Community countries have not yet joined the exchange rate mechanism and one participant adheres to a wider fluctuation

~~(Para. 5, 1st sub-para.) Pöhl suggests to replace wording in brackets by:~~ protected intra-European trade against excessive exchange rate volatility.

~~(Para. 5, 2nd sub-para.) Sentence between brackets suggested by Pöhl.~~

P2154.5

(Para. 5, 3rd sub-para.) Whole sub-para., slightly amended, is suggested by Pöhl.

and the establishment of the European Monetary Fund

margins. The transition to the second stage of the EMS, as foreseen by the Resolution of the European Council adopted in 1978, has not been accomplished.

setting up

6. An important element in t~~he launching of~~ the European Monetary System was the creation of the ecu. In establishing the EMS, the European Council declared in 1978 that "a European currency unit (ecu) will be at the centre of the EMS". Apart from being used as the numeraire of the exchange rate mechanism and ~~as a denominator for~~ operations in both the intervention and credit mechanisms, the ecu serves primarily as a reserve asset and a means of settlement for EMS central banks. Although it is an integral part of the EMS, the ecu has for a number of reasons played only a limited role in the operating mechanisms of the EMS. One reason is that compulsory intervention and the build-up of intervention balances to be settled in ecu has remained rather limited as central banks had increasingly recourse to intra-marginal intervention involving the use of partner currencies.

to denominate

~~(Para. 6, 1st sub-para.) Wording between brackets suggested by Pöhl.~~

By contrast, the ecu has gained considerable popularity in the market place, where its use as a denominator for financial transactions has spread significantly. In international banking, the ecu is at present the sixth most important unit of denomination and ranks fifth in international bond issues, with a 6% market share. A wide set of ecu instruments is ~~now~~ available for investors, both at the short and the long end of the market. Moreover, the creation of an ecu clearing system, in which more than thirty commercial banks now participate, has contributed to the development and ~~the~~ liquidity of the ecu market.

it

The expansion of financial market activity in ecu reflects in part a growing issuance of ecu-denominated debt instruments by Community institutions and public sector authorities of some member countries, ~~but also~~ the ecu's attractiveness as a means of portfolio diversification and as a hedge against currency risks. However, ~~as discussed in the Annex to this Report~~ the evolution of the ecu market has been rather uneven. International banking business and new ecu Euro-bond issues grew vigorously in the first half of this decade, but have moderated since then. The lion's share of banking business represents interbank transactions whereas direct business with non-banks has remained relatively small and appears to have been driven primarily by officially encouraged borrowing demand in a few

and in part

countries. Moreover, ecu-denominated deposits by the non-bank sector have stagnated since 1985, suggesting that the ecu's appeal as a near money substitute and store of liquidity is modest. In addition, in the non-financial sphere the use of the ecu for the invoicing and settlement of commercial transactions has remained limited, covering at present only about 1% of the Community countries' external trade. the end of 1992.

3. <u>The Single European Act and the internal market programme</u>

7. In January 1985 the Commission proposed to realise the objective technical
of a market without internal frontiers by ~~1992~~. The ~~essence of the~~ measures were
for the removal of physical, technical and fiscal barriers ~~was~~ set out in a White Paper, which specified the precise programme, timetable and methods for creating a unified economic area in which persons, goods, services and capital will be able to move freely. This objective~~, together with the necessary legal provisions,~~ was embodied in December 1985 in the <u>Single European Act</u>.

8. The Single European Act marked the first significant revision of the Treaty of Rome. It introduced <u>three important changes</u> in the Community's strategy for advancing in the integration process. Firstly, it greatly simplified the requirements of harmonising national law by limiting harmonisation to the essential standards. ~~and by systematic adoption of~~ Beyond this there is
mutual recognition of national norms and regulations. Secondly, it established a faster, more efficient and more democratic decision-making process by extending the scope of qualified majority voting and by giving the European Parliament a greater role in the legislative process. Thirdly, it reaffirmed the need to strengthen the Community's economic and social cohesion, to enhance the Community's monetary capacity in the perspective of economic and monetary union, to reinforce the Community's scientific and technological basis, to harmonise working conditions with respect to health and safety standards, to promote the dialogue between management and labour and to initiate action to protect the environment.

9. ~~C~~onsiderable progress has been made over the last three years in implementing the internal market programme. In December 1988 the European Council, meeting in Rhodes, noted that "at the halfway stage towards the

In particular, it has been decided that eight member countries will fully liberalise capital movements until 1st July 1990 and that the other member countries will follow suit after a period of transition.

deadline of December 1992, half of the legislative programme necessary for the establishment of the large market is already nearly complete" and underlined "the irreversible nature of the movement towards a Europe without internal frontiers". There is, indeed, widespread evidence that the objective of a single market enjoys broad support by consumers and producers and that their economic decisions are increasingly influenced by the prospects of 1992. The anticipation of a market without internal frontiers has generated a new dynamism and has contributed to the recent acceleration of economic growth in the Community.

4. Problems and perspectives

10. The ~~implementation~~ completion of the single market will link national economies much more closely together and significantly increase the degree of economic integration within the Community. This ~~development~~ will offer considerable opportunities for economic advancement because a unified enlarged economic ~~space~~ area will greatly increase the freedom of choice of market participants, raise their purchasing power and generate considerable possibilities for exploiting economies of scale and comparative advantages. However, ~~for~~ these ~~opportunities to be fully exploited, a~~ potential benefits will not be achieved without significant structural adjustment ~~is likely to be required~~. Both private market participants and policy makers will have to adapt their behaviour to changes in legislation and ~~the emergence of a new economic setting~~ to the evolving economic environment.

11. While the Community has made important progress in its process of integration in recent years, it has to be recognised that this process has been uneven and that there is a need for greater convergence in economic performance. Although there has been a distinct downward trend in the movement of both consumer prices and unit labour costs, the dispersion of inflation rates is still considerable. At the same time, despite efforts towards budgetary consolidation in several member countries, budgetary positions continue to deviate considerably throughout the Community and ~~external imbalances have accentuated markedly in the recent past~~. The existence of these ~~imbalances~~ divergencies ~~not only~~ points to areas where economic performances have to be made more convergent. ~~it also indicates that under present circumstances the use of the exchange rate as an instrument of adjustment could not yet be abandoned.~~

C

Doyle: referring to the previous draft of the Report, attaches importance to the discussion of regional policy issues presented in that draft; his suggestion summarising the regional aspects is as follows:
While the changes which will be brought about by EMU offer immense opportunities for economic advancement, it will be essential, in order to ensure the development of a more balanced economic structure throughout the Community, that Community regional and structural policies be enhanced and that there be a regional dimension to all economic policies.

This thought is essentially expressed in para. 32, 1st sub-para.

deadline of December 1992, half of the legislative programme necessary for the establishment of the large market is already nearly complete" and underlined "the irreversible nature of the movement towards a Europe without internal frontiers". There is ~~indeed~~ widespread evidence that the objective of a single market enjoys broad support by consumers and producers and that their economic decisions are increasingly influenced by the prospects of 1992. The anticipation of a market without internal frontiers has generated a new dynamism and has contributed to the recent acceleration of economic growth in the Community.

4. Problems and perspectives

Completion

10. The ~~implementation~~ of the single market will link national economies much more closely together and significantly increase the degree of economic integration within the Community. ~~This development will offer considerable opportunities for economic advancement because~~ A unified enlarged economic ~~space~~ area will greatly increase the freedom of choice of market participants, raise their purchasing power and generate considerable possibilities for exploiting economies of scale and comparative advantage~~s~~. ~~However, for these opportunities to be fully exploited, a significant structural adjustment is likely to be required.~~ Both private market participants and policy makers will have to adapt their behaviour to changes in legislation and ~~the emergence of a new economic setting~~.

11. While the Community has made important progress in its process of integration in recent years, it has to be recognised that this process has been uneven and that there is a need for greater convergence in economic performance. Although there has been a distinct downward trend in the movement of both consumer prices and unit labour costs, the dispersion of inflation rates is still considerable. At the same time, despite efforts towards budgetary consolidation in several member countries, budgetary positions continue to deviate considerably throughout the Community and external imbalances have accentuated markedly in the recent past. The existence of these imbalances not only points to areas where economic performances have to be made more convergent, it also indicates that under present circumstances the use of the exchange rate as an instrument of adjustment could not yet be abandoned.

It will promote growth

Doyle: referring to the previous draft of the Report, attaches importance to the discussion of regional policy issues presented in that draft; his suggestion summarising the regional aspects is as follows:

While the changes which will be brought about by EMU offer immense opportunities for economic advancement, it will be essential, in order to ensure the development of a more balanced economic structure throughout the Community, that Community regional and structural policies be enhanced and that there be a regional dimension to all economic policies.

This thought is essentially expressed in para. 32, 1st sub-para.

potential

These benefits will ~~not~~ not be achieved without significant structural adjustment.

to the evolving econonomic environment.

C

Although substantial progress has been made, the process of integration has been uneven. Greater convergence of economic performance is needed. Despite a marked downward trend in the average of price and wage inflation, differences in rates between countries remains ~~substantial~~ considerable. Also budgetary positions continue to differ greatly; and external imbalances have sharply increased ~~in the~~ recently. ~~These disequilibria show that performances will have to be made more convergent and that the use of the exchange rate instrument could not~~ be ~~abandoned under current circumstances~~

TEL: 41-61-238507 23.05.89 17:11 No.001 P.10

 With full

12. As economic interdependence increases, the room for independent policy manoeuvre will decrease. Freedom of capital movements and integrated financial markets would quickly translate incompatible national policies into exchange rate tensions and put an increasing and undue burden on monetary policy, if exchange rate realignments or recourse to safeguard clauses were to be avoided. The integration process thus requires more intensive and effective policy co-ordination, not only in the monetary field but also in all areas of national economic management affecting aggregate demand, prices and costs of production. ~~In particular, at the macro-economic policy level further efforts are~~ required. In the monetary field the weaknesses of the EMS, referred to above, continue to exist. Outside the EMS, policy co-ordination remains largely perfunctory, ~~and~~ Especially in the area of fiscal policy the 1974 Decision on economic convergence has not succeeded in establishing an effective foundation for policy co-ordination. To some extent the pressure for mutually consistent macro-economic policies has ~~so far~~ until now been lessened by the existence of capital controls in some countries and by the segmentation of markets through various types of non-tariff barriers. But full mobility of capital will become effective in 1990 and as the internal market programme is being implemented each country will be less and less shielded from developments elsewhere in the Community. ~~and~~ The attainment of national economic objectives will become more dependent upon a co-operative approach to policy-making.

A tighter coordination of economic policy-making is

13. The smooth progress in implementing ~~The success~~ ~~of~~ the internal market programme will depend ~~hinge~~ on the ~~Community's ability~~ to eliminate reducing the existing ~~current~~ imbalances and, ~~thereby on~~ The ~~its~~ capacity to strengthen and improve the co-ordination of its member countries' economic policies of the Community. ~~In their decision-making national authorities are frequently faced with many pressures and institutional constraints and even best efforts to choose a course of action mindful of international repercussions~~ are likely to fail at certain times. [While voluntary co-operation should be relied upon as much as possible to arrive at increasingly convergent national policies, thus taking account of divergent constitutional situations in member countries, there is also likely to be a need for more binding procedures.]

and the full realization of its benefits

National decision-making authorities are subject to many pressures and institutional constraints and even best efforts to take into account international repercussions

~~(Para. 13) Wording between brackets suggested by Pöhl.~~

14. Economic and monetary union has been an objective of the Community since 1971 and was confirmed by the European Council at its meeting on 27th-28th June 1988 in Hanover when this Committee was set up. The implementation of a market without internal frontiers constitutes an important step in the direction of economic and monetary union, but it does not lead by itself to the attainment of this final objective. As will be discussed in the following parts of this Report, economic and monetary union requires additional and far-reaching steps in all areas of economic policy-making.

F

In accordance with its mandate, the Committee has focused its attention on the question of how to achieve economic and monetary union. ~~It has not considered its task to enquire whether economic and monetary union is desirable, or which advantages could be expected from it.~~ Therefore, requirements and implications of economic and monetary union are discussed not in the light of a cost-benefit analysis, but as part of an investigation of the conditions under which such an union would be viable and successful.

and when

This requires a political decision.

~~In order to be able to set out such an approach it is essential to define clearly the final objective.~~ For this reason, the following part of this Report examines the principal features and implications of an economic and monetary union. The subsequent part then presents a pragmatic step-by-step approach which could lead in three stages to the final objective.

E

fr p 7

monetary policy and macro-economic management. A monetary union would require a single monetary policy and the responsibility for the formulation of this policy would consequently have to be vested in one decision-making body. In the economic field a wide range of decisions would remain the preserve of national and local authorities. However, given the impact that they might have on the overall domestic and external economic situation of the Community and their implications for the conduct of a common monetary policy, such decisions would have to be placed within an agreed macro-economic framework and be subject to binding rules which would [enable the Community to determine an overall policy stance,] avoid major differences between individual member countries in public sector borrowing requirements and put binding constraints on the financing of budget deficits.

(Para. 18, last sentence) Amended in accordance with suggestion by Pöhl; he also suggests deletion of the part between brackets.

19. An essential element in defining the appropriate balance of power within the Community would be the strict adherence to the constitutional "principle of subsidiarity", according to which the functions of higher levels of government should be as limited as possible and should be only subsidiary to those of lower levels. Thus, the attribution of competences to the Community would have to be confined to those areas in which collective decision-making was necessary, whereas all policy functions which could be carried out at national (and local) levels without adverse repercussions on the cohesion and functioning of the economic and monetary union would have to remain within the competence of the member countries.

20. The Committee feels that concrete proposals leading to economic and monetary union can only be made if there is a clear understanding and acceptance of the implications and requirements of the final objective, and if due account is taken of past experiences and developments with economic and monetary integration in the Community. Economic union and monetary union are closely intertwined, form two integral parts of a single whole and would therefore have to be implemented in parallel. It is for reasons of expositional clarity that the following sections look separately at the principal features defining an economic and a monetary union. This description begins with the concept of a monetary union, chiefly because an economic union can be circumscribed more clearly and specifically once the main elements of a monetary union have been identified.

(E)

to p 7

COMMISSION
OF THE
EUROPEAN COMMUNITIES

OFFICE OF THE PRESIDENT

7

14. The European Council which set up this Committee at its meeting on 27-28 June 1988, confirmed the objective of economic and monetary union for the Community. The completion of the internal market without frontiers will mark an important step in this direction, but it does not by itself lead to the attainment of the final objective. Economic and monetary union ~~is an important additional step~~ goes well beyond the single market programme and, as discussed in the following parts of this Report, it requires further far-reaching steps in all areas of economic policy making

II. The final stage of economic and monetary union

1. General considerations

15. Economic and monetary union in Europe would imply complete freedom of movement for persons, goods, services and capital, as well as irrevocably fixed exchange rates between national currencies or a single currency. This, in turn, would presuppose a high degree of integration and require a common monetary policy and consistent economic policies. These policies should be geared towards price stability, balanced growth and converging standards of living, high employment and external equilibrium. Economic and monetary union would represent the final result of the process of progressive economic integration in Europe.

16. Even after attaining economic and monetary union, the Community would continue to consist of independent nations with differing economic characteristics, traditions, social customs and languages. The existence and preservation of this plurality would necessitate that a degree of autonomy in economic decision-making continued to rest with individual member countries and that a balance were struck between national and Community competences. For this reason it would not be possible simply to follow the example of existing federal states; it would be necessary to develop an innovative and unique approach.

17. The Treaty of Rome, as amended by the Single European Act, provides the legal foundation for many of the necessary steps towards economic integration, but does not suffice for the creation of an economic and monetary union. The realisation of this objective would call for new arrangements which could only be established on the basis of a new Treaty and consequent changes in national legislations. The Treaty would lay down the functional and institutional arrangements, as well as provisions governing their step-by-step implementation.

(Para. 17) Leigh-Pemberton suggests to shift this para. 17 to the end of Part II; in his view the final sentence of para. 17 deserves a fuller treatment.

18. Taking into account what is already provided for in the EC Treaties, the need for a transfer of decision-making power from member states to the Community as a whole would arise primarily in the fields of X

(Para. 18) Leigh-Pemberton suggests that para. 18 could be omitted.

monetary policy and macro-economic management. A monetary union would require a single monetary policy and the responsibility for the formulation of this policy would consequently have to be vested in one decision-making body. In the economic field a wide range of decisions would remain the preserve of national and local authorities. However, given the impact that they might have on the overall domestic and external economic situation of the Community and their implications for the conduct of a common monetary policy, such decisions would have to be placed within an agreed macro-economic framework and be subject to binding rules which would [~~enable the Community~~ to determine an overall policy stance,] avoid major differences between individual member countries in public sector borrowing requirements and put binding constraints on the financing of budget deficits.

allow

for the Community as a whole,

(Para. 18, last sentence) Amended in accordance with suggestion by Pöhl; he also suggests deletion of the part between brackets.

19. An essential element in defining the appropriate balance of power within the Community would be the strict adherence to the constitutional "principle of subsidiarity", according to which the functions of higher levels of government should be as limited as possible and should be only subsidiary to those of lower levels. Thus, the attribution of competences to the Community would have to be confined to those areas in which collective decision-making was necessary, ~~whereas~~ all policy functions which could be carried out at national (and local) levels without adverse repercussions on the cohesion and functioning of the economic and monetary union would ~~have to~~ remain within the competence of the member countries.

20. The Committee feels that concrete proposals leading to economic and monetary union can only be made if there is a clear understanding and acceptance of the implications and requirements of the final objective, and if due account is taken of past experiences and developments with economic and monetary integration in the Community. Economic union and monetary union are closely intertwined, form two integral parts of a single whole and would therefore have to be implemented in parallel. It is for reasons of expositional clarity that the following sections look separately at the principal features defining an economic and a monetary union. The description begins with the concept of a monetary union, chiefly because an economic union can be circumscribed more clearly and specifically once the main elements of a monetary union have been identified.

R

to p 7

They

2. The principal features of monetary union

21. A monetary union describes a single currency area in which policies are managed jointly with a view to attaining common macro-economic objectives. As already stated in the 1970 Werner Report, there are three necessary conditions for a monetary union:

- the assurance of total and irreversible convertibility of currencies;
- the complete liberalisation of capital transactions and full integration of banking and other financial markets; and
- the elimination of margins of fluctuation and the irrevocable locking of exchange rate parities.

The first two of these requirements have already been met, or will be with the completion of the internal market programme. The single most important condition for a monetary union would, however, be accomplished only when the decisive step was taken to lock exchange rates irrevocably.

As a result of this step, national currencies would become increasingly close substitutes and their interest rates would tend to converge. ~~However,~~ the pace with which these developments took place would depend critically on the extent to which firms, households, labour unions and other economic agents were convinced that the decision to lock exchange rates would not be reversed. Initially, the continuing existence of national currencies might leave doubts about the commitment to unchangeable exchange rate parities and could engender market perceptions of differences between individual currencies' quality and standing. Both coherent monetary management and convincing evidence of an effective co-ordination of non-monetary policies would be crucial in dispelling such doubts over time.

22. The three above-mentioned requirements are necessary for the establishment of a single currency area, but their implementation would not necessarily mark the end of the process of monetary unification in the Community. The adoption of a single currency, while not strictly necessary for the creation of a monetary union, might be seen - for economic as well as psychological and political reasons - as a natural and desirable further

Tima align with brackets at end of last para

P11 L14

(Para. 22) Leigh-Pemberton would prefer the introduction of a single currency as soon as possible after the locking.

(Para. 22) Ciampi recalls that the formulation "the ecu should develop ..." instead of "the ecu has the potential to develop ..." had been adopted at the February meeting.

development of the monetary union. A single currency would clearly demonstrate the irreversibility of the move to monetary union, considerably facilitate the monetary management of the Community and have a much greater weight relative to other major currencies than any individual Community currency. ~~[In this connection, it would be desirable to endorse the idea that the ecu has the potential to develop into the future currency of the Community and an official declaration to this effect should be made at the time of the decision to draw up a new Treaty. This would imply that the present basket ecu is replaced by a new abstract ecu at the time of transition to the common currency. The transition would have to be made without discontinuity between the present ecu and the future single currency: any debt contracted in ecus before the introduction of the single currency would have to be payable at face value in ecus if, at maturity, the transition to the single currency had been made.~~ [The replacement of national currencies by a single currency would take a certain time. ~~and~~ It would require that economic agents had become sufficiently acquainted with ~~the ecu and that its use in commercial and financial transactions had spread.~~ the new currency].

23. The establishment of a monetary union would have far-reaching implications for the formulation and execution of monetary policy in the Community. Once permanently fixed exchange rates had been adopted, ~~but national currencies continued to exist in an environment of free and fully integrated capital and money markets~~ there would be a need for a single monetary policy, ~~to be carried out through~~ new operational procedures ~~and~~ which would ~~not simply through~~ the co-ordination of as many national monetary policies as there were currencies participating in the union would not be sufficient. ~~This, in turn, would require the attribution of~~ The single responsibility for monetary policy ~~to~~ would have to be vested in a new institution, ~~the European System of Central Banks (the principal features of which are outlined in Section 4 below)~~, in which centralised and collective decisions on the supply of money and credit in the Community would be taken.

This shift from national monetary policies to a single monetary policy is an inescapable consequence of entering a monetary union and would mark one of the ~~principal institutional~~ changes required by economic and monetary union. ~~[In practice, however, the incision would not be so deep, but rather would represent the completion of a progressively intensified co-ordination of national monetary policies, which had in many respects~~

- 11 -

~~(Para. 22) Alternative text proposed by Pöhl:~~
~~It is probably too early for a decision that the present ecu should develop into the future currency of the Community. The present basket ecu assumes the existence of its component currencies. Their disappearance would by definition also mean that the existing ecu would have to be replaced by a new abstract ecu at the time of transition to the common currency. In any case the transition would have to be made without discontinuity from the existing basket ecu if it were so decided. Adequate time would be required for economic agents to become acquainted with the new ecu and its characteristics.~~

~~(Para. 23, 2nd sub-para.) Alternative text proposed by Pöhl:~~
Although a progressively intensified co-ordination of national monetary policies would in many respects have prepared the move to a single monetary

policy, the implication of such a move would be far-reaching. Together with the permanent fixing of exchange rates it would deprive individual countries of the principal instrument available to correct economic imbalances and act independently in pursuit of national objectives, especially price stability. This loss would be most intensely felt by those countries that had retained some room for manoeuvre to pursue stability objectives under the less binding EMS rules.

~~already foreshadowed the move to a single monetary policy in the Community.]~~

Even prior to the decision to fix exchange rates permanently, the full liberalisation of capital movements and financial market integration will create a situation in which the co-ordination of monetary policy will have to be strengthened progressively. Once every banking institution in the Community is free to accept deposits from, and to grant loans to, any customer in the Community and in any of the national currencies, the large degree of territorial coincidence between the national central banks' area of jurisdiction, the area in which their currency is used ~~and the area in which "their" banking system operates~~ will be lost, ~~and~~ In these circumstances the effectiveness of national monetary policies will become increasingly dependent upon co-operation among central banks. Indeed, the growing co-ordination of monetary policies will make a positive contribution to financial market integration and will help central banks ~~to~~ gain the experience that is necessary for moving to a single monetary policy.

X

~~24. In summary, the realisation of a monetary union would mean that in a situation of free capital movements and full financial integration the exchange rates between Community currencies would be irreversibly fixed. This would create a monetary union in which all national currencies became increasingly close substitutes for each other and might eventually be replaced by [the ecu as the] sole Community currency. The transition from a situation of fixed but adjustable exchange rates to a system of permanently locked parities would imply a fundamental change in the economic as well as the monetary management of the Community. National monetary policies would have to give way to a single monetary policy for the Community as a whole, formulated and executed jointly in the context of a European System of Central Banks. At the same time, a single currency area would imply the abandonment of the exchange rate as an instrument of adjustment of imbalances among Community countries and would therefore require, in parallel to the process of monetary integration, effective measures to enforce policies in non-monetary areas.~~

(Para. 24) Pöhl ~~suggests to omit reference to the ecu.~~

3. The principal features of economic union

25. Economic union - in coexistence with a monetary union - combines the characteristics of an unrestricted common market with a set of rules which are indispensable for its proper working. In this sense economic union can be described in terms of four basic elements:

- the single market within which persons, goods, services and capital can move freely;
- competition policy and other measures aimed at strengthening market mechanisms;
- common policies aimed at structural and regional development; and
- macro-economic policy co-ordination, including binding rules for budgetary policies.

In identifying the content and limits of specific rules and arrangements defining an economic union, the Community should be guided by two considerations.

Firstly, the economic union should be inspired by the same market-oriented economy principles that constitute the foundation of the economic order of its member countries. Differences in policy choices may exist between member countries or - within the same country - in different periods. However, beyond such differences, a distinctive common feature of economic systems in Europe is the combination of a large degree of freedom for market behaviour and private economic initiative with public intervention in the provision of certain social services and public goods.

Secondly, an appropriate balance between the economic and the monetary components should be ensured for the union to be viable. This would be essential because of the close interactions between economic and monetary developments and policies. A coherent set of economic policies at the Community and national levels would be necessary to maintain permanently fixed exchange rates between Community currencies. ~~and conversely~~ Also, a common monetary policy, in support of a single currency area, would be necessary for the Community to develop into an economic union.

[~~26. The measures aimed at creating the single market are to a large extent envisaged in the Treaty of Rome and the Single European Act. With~~

- 13 -

(Para. 25, third indent) Leigh-Pemberton suggests "possible common policies ..." in third indent.

(Para. 26) Pöhl suggests to delete para. 26; he comments:

The text also assumes partial harmonisation of national tax treatment, but nowhere in the text is there firm support for the idea that tax authority should be (partly, largely, in good part?) vested with the Community (i.e. a future European Parliament), as part of the needed degree of uniformity of fiscal policy, and in response to the need for built-in redistribution mechanisms to deal with the effects of regional imbalances (in place of otherwise unavoidable large-scale demands for fiscal transfers).

Leigh-Pemberton suggests redraft to make clear that a common monetary policy and a single currency are not necessary for economic union, though they may be desirable; he also suggests that para. 26 could be expanded to give greater detail on a "soft" union which goes beyond the single market as described here.

their implementation, by 1992, all barriers which tend to separate markets along national borders will be eliminated. In particular, all technical and regulatory obstacles will be removed, norms will be harmonised or mutually recognised, and certain common minimum standards governing social policy and consumer and environmental protection will be agreed. Moreover, differences in national tax treatment may have to be reduced to avoid severe distortion in the competitiveness of industries operating in different countries of the Community.

The creation of a single market will impart strong impulses to economic growth and increase economic welfare through both a further specialisation in line with countries' and regions' comparative advantages and the exploitation of economies of scale in production, research and marketing. These gains will materialise as the residents in the enlarged market without internal frontiers respond to price, wage and interest rate movements, which, transmitted throughout the Community, will provide important incentives for better allocation of factors of production and for a more efficient use of economic resources. There is no doubt that this process will stimulate economic activity and employment in the Community as a whole, and will generate greater economic freedom and increased trade in goods and services.]

27. The creation of a single currency area would ~~further enhance the advantages~~ add to the political benefits of an enlarged economic ~~space~~ area because it would remove intra-Community exchange rate uncertainties and lower transactions costs, eliminate the possibility of movements of exchange rates unwarranted by fundamental factors, contribute in the longer run to the evolution of a more homogeneous economic structure in the Community and reduce the susceptibility of the Community to external shocks.

At the same time, however, exchange rate adjustments would no longer be available as an instrument to correct economic imbalances within the Community. Such imbalances might arise because the process of adjustment and restructuring set in motion by the removal of physical, technical and fiscal barriers is unlikely to run smoothly or always produce satisfactory results within reasonable periods of time. Imbalances might also emanate from labour and other cost developments in one member country, external shocks with differing repercussions on individual economies, or divergent economic policies pursued at national levels.

With parities irrevocably fixed, foreign exchange markets would cease to provide a source of pressure for national policy corrections when national economic disequilibria developed and persisted. Moreover, the statistical measurement and the interpretation of economic imbalances might become more difficult because in a fully integrated market balance-of-payments figures, which are currently a highly visible and sensitive indicator of economic disequilibria, would no longer play such a significant role as a guidepost for policy-making. Nonetheless, such imbalances if left uncorrected would manifest themselves as regional disequilibria. Measures designed to strengthen the mobility of factors of production would be one way to deal with such imbalances.

28. ~~The~~ To creat~~ion~~e ~~of~~ an economic and monetary union ~~would need to complement~~ the single market through action in three interrelated areas: competition policy and other measures aimed at strengthening market mechanisms; common policies to enhance the process of resource allocation in those economic sectors and geographical areas where the working of market forces needed to be reinforced or complemented; macro-economic co-ordination, including binding rules in the budgetary field and other arrangements both to limit the scope for divergences between member countries and to design an overall economic policy framework for the Community as a whole.

would have to be complemented

29. Competition policy - conducted at the Community level - would have to operate in such a way that access to markets would not be impeded and market functioning not be distorted by the behaviour of private or public economic agents. Such policies would have to address conventional forms of restrictive practices and the abuse of dominant market positions, but would also have to deal with new aspects of antitrust laws, especially in the field of merger and takeover activities. [The use of government subsidies to assist particular industries should be strictly circumscribed because they distort competition and cause an inefficient use and allocation of scarce economic resources.]

30. Community policies in the regional and structural field would be necessary ~~[of paramount importance,]~~ in order to promote an optimum allocation of resources and to spread welfare gains throughout the Community. Without

- 15 -

(Para. 29) Sentence between brackets amended as suggested by Pöhl.

(Para. 30, 1st sub-para.) Leigh-Pemberton: not all countries regard resource transfer as a solution to these problems; he wishes also to say that there are no easy options and that experience to date (at the national and Community level) does not offer reassurance that such policies would be effective.

within the Community

adequate consideration for regional imbalances, the economic union would be faced with grave economic and political risks. For this reason particular attention would have to be paid to an effective Community policy aimed at cushioning regional and structural disparities and promoting a balanced development throughout the Community. In this context the regional implications of other Community policies would have to be taken into account.

~~The creation of a single market and the locking of exchange rates would take place in a situation in which, owing~~ to ill-adapted structures and differences in productivity, ~~some major regional disparities would still exist~~. The impact of economic and monetary integration on ~~these~~ regional disparities ~~may be~~ difficult to assess: on the one hand, economic integration would provide less developed regions with lower wage levels with an opportunity to attract modern and rapidly growing service and manufacturing industries for which the choice of location would not necessarily be determined by transport costs and market proximity. On the other hand, however, transport costs and economies of scale would tend to favour a shift in economic activity away from less developed regions, especially if they were at the periphery of the Community, to the highly developed areas at its centre. [The economic and monetary union should avoid undue economic and political tensions arising from possible dislocations of industries and labour forces. Therefore, it would have to encourage and guide structural adjustment which would help the Community's poorer regions to catch up with the wealthier ones.] To this end, the Community would have to develop further an effective policy and be endowed with adequate financial resources to allow it to support regional development efforts undertaken at national levels.

linked to

(Para. 30, 2nd sub-para.) Leigh-Pemberton suggests redraft: If economic and monetary union were to be undertaken before the disparities were reduced, to avoid ... forces, the Community would have to encourage ...

A step in this direction was taken in February 1988 when the European Council decided to strengthen and reorganise the Community's regional policies in several respects: the size of structural funds will be doubled over the period up to 1993, emphasis will be shifted from project to programme financing, and a new form of partnership will be established between the Community and the receiving regions. In the process of creating economic and monetary union such policies might have to be strengthened further after 1993, depending upon the speed of progress towards economic and monetary union.

and structural

[At the same time, excessive reliance on financial assistance through regional and structural policies could cause tensions. ~~that need to be avoided~~. The principal objective of regional policies should not be to subsidise incomes and simply temper inequalities in standards of living, but to help to equalise production conditions through investment programmes in such areas as physical infrastructure, communication, transportation and education so that large-scale movements of labour do not become the major adjustment factor. The success of these policies will hinge not only on the size of the available financial resources, but to a decisive extent also on their efficient use and on the private and social return of the investment programmes. Indeed, ~~the more~~ recent experience of countries inside and outside the Community has shown that structural and regional development programmes have been particularly successful when improvements in the resource base of regions, encouraged by investment in infrastructure and education, have been reinforced by decentralised initiatives for local entrepreneurship, modernisation of urban areas and local institutional arrangements favouring development. A long-term approach would offer countries with lower levels of productivity an appropriate period of transition and in this sense would constitute an essential element of the policy mix to ensure continuing economic integration.

Apart from regional policies, the Treaty of Rome, as amended by the Single European Act, has laid the foundations ~~of~~ for Community policies ~~aimed at common goals~~ in areas such as infrastructure, research and technological development, and environment. Such policies would not only enhance market efficiency and offset market imperfections, but could also contribute to regional development. Subject to the limits of the principle of subsidiarity, such policies would have to be developed further in the process towards economic and monetary union.] × for

[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 and employment in areas with deteriorating competitiveness. In order to reduce adjustment burdens temporarily, it might be necessary in certain circumstances to organise financing flows through official channels. Such financial support would be additional to what might be provided by spontaneous capital flows or external borrowing and should be granted on

P15 L36.5

(Para. ~~20~~ 28, 4th and 5th sub-paras.) Leigh-Pemberton suggests to omit the two sub-paras. between brackets.

P16 L23

(Para. ~~30~~ 28, 7th sub-para.) Doyle suggests deletion of this sub-para.

terms and conditions that would prompt the recipient to intensify its adjustment efforts.]

31. [Macro-economic policy is the third area in which action would be necessary for a viable economic and monetary union. This would require an appropriate definition of the role of the Community ~~in~~ the co-ordination of economic policies.

in promoting price stability and economic growth through

(Para. 31) Leigh-Pemberton suggests to omit the paras. between brackets (starting at the beginning of para. 31 and ending with the 4th sub-para.).

The major developments affecting macro-economic conditions would continue to be determined by factors and decisions operating at the national level. This would apply not only to wage negotiations and other economic behaviour in the fields of production, savings and investment, but also to the action of public authorities in the economic and social sphere. Aside from the system of binding rules governing the size and the financing of national budget deficits, decisions on the main components of public policy in such areas as internal and external security, justice, social security, education, and hence on the level and composition of government spending as well as many revenue measures would remain the preserve of member states even at the final stage of economic and monetary union. ~~Only if the provision of major public goods constituting the bulk of public sector activity were attributed to a large extent to the Community level would the Community budget be significantly enlarged.~~

However, an economic and monetary union could only operate on the basis of mutually consistent and sound behaviour by governments, unions and other economic agents in all member countries. In particular, unco-ordinated and divergent national budgetary policies would undermine monetary stability, generate imbalances in the real and financial sectors of the Community and render it impossible to pursue appropriate macro-economic policies for the Community as a whole. Similarly, strong divergences in wage levels, not justified by different trends in productivity, would produce economic tensions and pressures for monetary expansion.

To some extent market forces would exert a disciplinary influence. ~~because~~ Financial markets, consumers and investors would respond to differences in macro-economic developments in individual countries and regions, assess the budgetary and financial position ~~of different countries~~, penalise deviations from commonly agreed fiscal guidelines or wage settlements, and thus exert pressure for sounder policies. However, experience suggests that market perceptions do not necessarily provide strong and compelling signals and that access to a large capital market may for some time even facilitate the financing of economic imbalances. Rather than leading to a gradual adaptation of borrowing costs, market views about the creditworthiness of official borrowers tend to change abruptly and result in the closure of access to market financing. The constraints imposed by market forces might either be too slow and weak or too sudden and disruptive. Hence ~~This is why~~ countries will have to accept that sharing a common market and a single currency area imposes policy constraints.

In the general macro-economic field, an overall assessment of the short-term and medium-term economic developments of the Community should be agreed periodically and constitute the framework for a better co-ordination of national economic policies. The Community should be in the position to monitor its overall economic situation, to assess the consistency of developments in individual countries with regard to common objectives and to formulate guidelines for policy.

As regards wage formation and industrial relations, the autonomous negotiating process of social partners should be preserved, but efforts should be made to convince European management and labour of the advantages of gearing wage policies largely to improvements in productivity. Governments, for their part, should refrain from direct intervention in the wage and price formation process.

[In the budgetary field, particular arrangements would be necessary. Such arrangements should, firstly, impose effective and binding limits on budget deficits that could be incurred by individual member countries of the Community, although in setting these limits the situation of each member country might have to be taken into consideration. Secondly, the arrangements would have to include (in accordance with the criteria laid down for a European System of Central Banks) strict limits - both in size and duration - on the maximum permissible access to central bank credit and other forms of monetary financing, as well as on borrowing in non-Community currencies. Thirdly, the arrangements should enable the Community to conduct a coherent mix of fiscal and monetary policies, i.e. to dispose of a system of rules that could be applied with a view to determining the aggregate balance on national budgetary positions, including that of the Community.]

P18 L11

(Para. ~~31~~ 29, 7th sub-para.) <u>Alternative text proposed by Pöhl</u>:
In the budgetary field binding rules are required that would, firstly, impose effective upper limits on budget deficits of individual member countries of the Community; secondly, exclude access to direct central bank credit and limit recourse to external borrowing, including borrowing in non-Community currencies. With a view to effective control and co-ordination of market borrowing by public entities at all levels, a "public finance co-ordinating authority" consisting of representatives of all such entities should be established. One of its objectives would be to facilitate the conduct of a coherent mix of fiscal and monetary policies.

32. In summary, the establishment of an economic union would require:

- the creation of an internal market without physical, technical or fiscal frontiers, supplemented by a competition policy which effectively removes distortions in competition;
- a system of policies to stimulate regional and structural developments through multi-annual investment programmes, which would help regions with lower productivity to catch up with the more developed parts of the Community;
- [- common policies with regard to infrastructure, research and technological development, and environment, which would help to exploit the full potential of the single market and complement its role in the allocation of resources;
- consideration of the social dimension of the European Community;
- a framework for monitoring and co-ordinating general short-term and medium-term economic developments in the Community with a view to attaining non-inflationary, balanced economic growth;]
- effective and binding rules, which would ensure a coherent macro-fiscal policy stance in the Community, exclude access to direct central bank credit and limit recourse to borrowing in third currencies.

(Para. 32, 3rd-5th indent) Leigh-Pemberton suggests to omit the three indents between brackets.

(Para. 32, last indent) Amended as suggested by Pöhl.

4. Institutional arrangements

33. Management of the economic and monetary union would call for an institutional framework which would allow policy to be decided and executed at the Community level in those economic areas that were of direct relevance for the functioning of the union. The institutional framework would have to promote efficient economic management, properly embedded in the democratic process. ~~The creation of a~~ Economic and monetary union would ~~necessitate the setting up~~ require the creation of a new monetary institution, placed in the constellation of Community institutions (European Council, Council of Ministers, European Parliament, Commission and Court of Justice). ~~Although the establishment of economic union~~ would not necessarily require ~~the creation of~~ a new institution, the formulation and implementation of common policies in non-monetary fields and the co-ordination of policies under the competence

Moreover,

is needed

of the Community should

but

of national authorities ~~could require~~ a revision and, possibly, some restructuring of existing Community institutions could be necessary.

34. ~~The need for~~ A new monetary institution ~~arises~~ because a single monetary policy cannot result from independent decisions and actions by different central banks ~~and because~~ day-to-day monetary policy operations cannot respond quickly to changing market conditions unless they are decided centrally. ~~The Community's monetary institution responsible for~~ domestic and international monetary policy ~~could~~ be organised according to some federal form that might be called a European System of Central Banks (ESCB). The System would have to be given the status of a ~~new and~~ autonomous institution of the Community, operating under the provisions of the Treaty and could consist of a central institution (with its own balance sheet), and the national central banks. At the final stage the ESCB - acting through its Council - would be responsible for formulating and implementing monetary policy as well as managing the Community's exchange rate policy vis-à-vis third currencies. The national central banks would be entrusted with the implementation of policies in conformity with guidelines established by the Council of the ESCB and in accordance with instructions from the central institution.

Considering the political structure of the Community and the possibility of making existing central banks part of the new institution, the

full

It would

The European System of Central Banks should ~~rest~~ be based on the following ~~basic~~ principles:

Mandate and functions

- the System would be responsible for the formulation of monetary policy at the Community level and its implementation at the national level, for the full convertibility of European currencies, and for the maintenance of a properly functioning payment system; [the System would have to regulate the amount of money in circulation and the volume of credit supplied by banks and other financial institutions ~~on the basis of criteria designed to ensure price stability as well as economic growth;~~]
- the System would ~~[be responsible for the formulation of banking supervisory policy at the Community level and for]~~ co-ordination of banking supervision policies of the national supervisory authorities.

P19 L43

~~(Mandate and functions, 1st indent) Pöhl suggests: the System ... other financial institutions~~ with a view to safeguarding overall price stability]
(Mandate and functions, 1st indent) Leigh-Pemberton suggests: the System would be committed to promoting price stability as well as economic growth.
~~(Mandate and functions, 2nd indent) Pöhl~~: participate in the

Status

- independence of instructions from national governments and Community authorities;
- proper democratic legitimisation through reporting and appointment procedures;
- appointment of the members of the Board by the European Council on the proposal of the ESCB Council; the tenure of Board members would be for five to seven years and would be irrevocable;
- transmission of an annual report by the ESCB to the European Council and the European Parliament; the Chairman of the Board could be invited to report to these institutions;
- supervision of the administration of the System independently of the Community bodies, for example by a supervisory council or a committee of independent auditors.

(Status, 3rd indent) Leigh-Pemberton suggests omission of the three indents; if detail is necessary, it would be better to have it in Part III.

Structure and organisation

- a federative structure, since this would correspond best to the political structure of the Community;
- establishment of a European Central Bank Council (composed of the Governors of the central banks and the members of the Board), which would be responsible for the formulation of and decision on the thrust of monetary policy;
- establishment of a Board (with supporting staff), which would monitor monetary developments and oversee the implementation of the common monetary policy;
- national central banks, which would execute operations in accordance with instructions given by the Board.

Policy instruments

- the instruments available to the System, together with a procedure for amending them, would be specified in its statutes; the instruments would comprise both regulatory powers and the authority to conduct central banking operations in money and foreign exchange markets;
- there would be strict limitations on lending to all public authorities;

(Policy instruments, 1st indent) Leigh-Pemberton: it is unnecessary to specify in the statutes the instruments available; it is also not clear why the ESCB should need authority to conduct central banking operations in money and foreign exchange markets.

- the monetary policy instruments would be oriented towards a free market economy.

35. In contrast to the monetary field, in the economic field an institutional framework for performing policy tasks is already in place, with different and complementary functions conferred to ~~the Council,~~ the European Parliament, ~~the Commission~~ and the Court of Justice. The new Treaty would therefore not have to determine the mandate, status and structure of a new institution but to complement and adapt the role of the existing institutions in the light of the policy functions they would have to fulfil in an economic and monetary union. The new Treaty would have to specify this adaptation and determine the areas where additional decision-making authority would have to be transferred from the national to the Community level.

the Council of Ministers, the Monetary Committee, the Commission

(Para. 35, 1st sub-para.) Amended as suggested by Pöhl.

General criteria

In order to ensure a flexible and effective conduct of policies in those economic areas in which the Community would be involved, several basic requirements would have to be fulfilled:

- ~~to the extent that~~ where policies were decided and enacted at the Community level, there would have to be a clear distribution of responsibilities among the existing Community institutions, with due regard to whether decisions relate to the setting of broad policy directions or to day-to-day operations in the light of current developments. By analogy with the structure of the European System of Central Banks, where the ESCB Council would determine the broad lines of monetary policy and the day-to-day execution of these policies would be in the hands of the Board, a similar allocation of responsibilities could be envisaged in the economic field by reserving the right to determine the broad lines of economic policy to the Council of Ministers, while the day-to-day execution of these policies would be in the hands of the Commission;
- in case of non-compliance by member states, the Commission would have the responsibility for taking effective action to assure compliance; the nature of such action would have to be explored;

(General criteria, 1st indent) Addition suggested by Pöhl.

(General criteria, 2nd indent) Additional indent suggested by Pöhl; Duisenberg suggests a similar formulation.

- ~~in those areas in which~~ where the Community's role would be to co-ordinate policies that are decided and implemented by member countries, compliance with the Community's policy framework would have to rely on a system of binding rules ~~to~~ on individual member states, including the possibility - for the Council or the Commission - to impose sanctions in the event of departures from the agreed policy line;

[- discretionary changes in Community resources, in the level of harmonised taxation rates and in the terms and conditions attached to structural policies and Community loans should become available instruments and incentives in support of agreed policies.]

Single market and competition policy

In these two areas, the necessary procedures and arrangements have already been established by the Treaty of Rome and the Single European Act, which conferr~~ing~~ upon the Community the necessary legislative, executive and judicial authority. ~~While for economic agents~~ the completion of the internal market will result in a ~~represents~~ marked easing of the overall burden of regulation for economic agents, but for the Community institutions it ~~the 300 new directives necessary to create and maintain the single market~~ will ~~represent~~ mean a substantial addition to their executive and policing functions. New instruments and procedures to enforce the rules of the single market might prove necessary after 1992.

Community policies in the regional and structural field

The foundations for a more effective Community role in regional and structural development have recently been put in place, involving both a doubling of the resources of structural funds and a reorganisation of policies as described in earlier parts of this report. These mechanisms might have to be further extended and made more effective as part of the process leading to economic and monetary union.

~~Macro-economic policy~~

~~The broad objective of co-ordination of general economic policies would be to promote growth and employment in an environment of price stability and economic cohesion. For this purpose co-ordination would involve: defining medium and short-term policy approaches, bearing in mind~~

P22 L11

(General criteria, 4th indent) Leigh-Pemberton notes that there is no commitment to harmonise tax rates and that it is not clear what institution is supposed to be recommending ...

(~~Macro-economic policy~~) ~~Alternative text proposed by Pöhl~~

The broad objective of economic policy co-ordination would be to promote growth, employment and external balance in an environment of price stability. For this purpose co-ordination would involve defining a their economic and social implications; participating in the policy co-ordination with the other areas of the industrial world; setting a multi-year framework for national and Community budgetary policies; managing common policies, particularly with a view to improving structural and regional development; and determining, in close consultation with the the ESCB Council, the Community's exchange rate policy.

New procedures would have to be developed. Firstly, they would have to strike a balance between co-ordination through binding rules and discretionary co-ordination adapted to a particular economic situation. Secondly, they would have to cover both horizontal co-ordination - between member countries and the Commission and the Council - and vertical co-ordination between a member country and the Commission.

In this context it would be necessary to develop an effective procedure for joint decision-making in the field of budgetary policy. This would involve:

- the definition of the overall stance of fiscal policy, i.e. the size and the financing of the aggregate budgetary position of all member countries;
- binding rules and collective decisions concerning budget deficits which could be incurred by individual countries;
- strict limits on the maximum permissible access to monetary financing as well as on borrowing in non-Community currencies.]

36. [Relationships and interactions between the existing Community institutions (European Council, Council of Ministers, European Parliament, Commission and Court of Justice) and the European System of Central Banks would have to be defined not only in order to construct a consistent institutional framework, but also to ensure an effective procedure of consultation and co-ordination between budgetary and monetary policies. This should not however, impinge on the policy responsibilities entrusted to each institution. Such consultation procedures could include participation by the President of the Council and the President of the Commission in meetings of the ESCB Council, and participation by the Chairman of the ESCB Council in meetings of the Council of Ministers. An involvement of the European Parliament and national parliaments in the co-ordination process could be considered in addition to the role to be

medium-term framework for budgetary policy within the economic and monetary union; managing common policies with a view to structural and regional development; determining, in close consultation with the ESCB Council, the Community's exchange rate policy; and participation in policy co-ordination at the international level.

New procedures required for this purpose would have to strike a balance between the reliance of binding rules where necessary to ensure effective implementation and discretionary co-ordination adapted to particular situations.

In particular it would seem necessary to develop procedures and binding rules for budgetary policy, involving enforceable decisions taken by majority:

- the definition of the overall stance of fiscal policy over the medium term, including the size and financing of aggregate budgetary positions in the Community;
- strict limitations on public borrowing, e.g. related to public investment requirements;
- exclusion of access to central bank credit and other monetary financing;
- strict limitation of borrowing in non-Community countries.

(Para. 36) Alternative text proposed by Pöhl:

The new Treaty laying down the objectives, features, requirements, procedures and organs of the economic and monetary union would add to the existing Community institutions (European Council, Council of Ministers, European Parliament, Commission and Court of Justice) a new institution of comparable status, the European System of Central Banks. With due respect for the independent status of the ESCB, as defined elsewhere in this Report, appropriate consultation procedures will have to be set up to allow for effective co-ordination between budgetary and monetary policy. To this end, attendance by the President of the Council and the President of the Commission at meetings of the ESCB Council, without power to vote or to block decisions taken in accordance with the rules laid down by the ESCB Council, should be provided for. Equally, attendance by the Chairman of the ESCB Council at meetings of the Council of Ministers should be provided for, especially on matters relating to budgetary and other policies of relevance to the conduct of monetary policy. Consideration would have to be given to the role of the European Parliament, especially in relation t the authority evolving on the Commission in budgetary matters, where the latter should be accountable to the European Parliament. The same should apply in regard to action, or non-action, taken by the Commission in response to non-compliance of a member country with binding rules or decisions especially in the budgetary field.

(Para. 36) Duisenberg suggests a change similar to that in the second half of Pöhl's proposal.

(Para. 36) Ciampi doubts whether it is wise to make such specific proposals on participation.

played by the Council and the Commission, and the European Parliament could be consulted in advance on the stance of economic policy in the Community. The consultation process should include a yearly joint assessment of the overall economic and monetary situation and prospects, and the formulation of a general policy guideline for the year to come. Moreover, the Council of Ministers and the Commission would submit a report each year to the European Council and the European Parliament on the functioning and the status of the economic and monetary union.]

P24 L8

5. Economic and monetary union in the context of the world economy

(Section 5) Leigh-Pemberton suggests to omit this section.

37. The realisation of an economic and monetary union would give a more important voice to the Community in international negotiations and enhance its capacity to influence the relations among industrial and developing countries in a wide range of areas such as trade policies, international monetary matters, macro-economic policy concertation and the North-South dialogue.

38. The competence for external trade policy has been attributed to the Community in the Treaty of Rome and the Commission, acting as the Community's spokesman, represents all member countries in multilateral trade negotiations. This role will be strengthened with the completion of the single market which has the potential to stimulate multilateral trade and economic growth at the global level. However, this potential can only be exploited to its full extent in an open trading system, guaranteeing foreign suppliers free access to the Community market and, conversely, exporters from the Community free access to foreign markets. The removal of internal trade barriers within the Community should constitute a step towards a more liberal trading system on a worldwide scale.

39. The creation of a single currency area and, concomitantly, the move to a single monetary policy conducted by the European System of Central Banks will change the role of the Community in international monetary matters. The Community would have to assume a growing responsibility for international monetary developments, both ~~with regard to~~ in the field of ~~more~~ short-term co-operation ~~at the level of~~ between central banks ~~in~~ over interest rate management and exchange market interventions ~~as well as~~ and of in the search for

solutions to issues relating to the further development of the international monetary system.

40. As economic and monetary union necessitates an effective macro-economic management for the Community as a whole, it would also strengthen the Community's position in the process of international policy concertation among major industrial countries. However, for the Community to play its part in this respect, the arrangements for internal macro-economic policy formulation and implementation would have to be sufficiently flexible, allowing the Community not only to respond effectively to changing economic circumstances in its internal economic situation, but also to be able to co-ordinate policies in a manner satisfactory to both the Community and other major industrial countries.

41. The institutional arrangements which would enable the Community to fulfil the new responsibilities implied by its increased weight in the world economy are partly in place or would be implemented in the process of creating an economic and monetary union. In the area of external trade policies and, to some extent, in the field of co-operation with developing countries, the responsibilities have already been attributed to the Community. With the establishment of the European System of Central Banks the Community would also have created an institution through which it could participate in all aspects of international monetary management. As far as macro-economic policy co-ordination at the international level is concerned, the Community as such is currently represented only at the summit meetings of the major industrial countries. In order to make full use of its position in the world economy and to exert influence on the functioning of the international economic system, the Community would have to be able to speak with one voice. This emphasises the need for an effective mechanism for macro-economic policy co-ordination within the economic and monetary union.

III. **Steps towards economic and monetary union**

42. After defining the main features of the final setting of economic and monetary union, the Committee has undertaken the "task of studying and proposing concrete stages leading towards this union". ~~In this context the Committee considered the possibility of combining in a first stage measures to strengthen convergence with a limited operational and institutional step preceding more far-reaching institutional changes in subsequent stages. The limited step would, as described in para. 65 below, involve the creation of a European Reserve Fund in which a certain amount of reserves would be permanently pooled. For the reasons explained in para. 66 below, this proposal was not accepted by several members of the Committee. However, the~~ The Committee agreed that the creation of economic and monetary union must be viewed as a process which represents a single entity. Although set out in stages which guide the progressive movement to the final objective, the decision to enter the first stage should be a decision to embark on the entire process. The implementation of the concrete measures proposed for stage one demands a political decision to create an economic and monetary union in Europe and the conclusion of a new Treaty in stage one.

from para 47.

Line! In the margin all the references to para 42, which are now on page 30

1. Principles governing a step-by-step approach

43. In designing a step-by-step approach along the path to economic and monetary union the general principle of subsidiarity, referred to earlier in this Report, as well as a number of further considerations, would have to be taken into account.

44. Discrete but evolutionary steps. The process of implementing economic and monetary union would have to be divided into a limited number of clearly defined stages. Each stage would have to represent a significant change with respect to the preceding one. New arrangements coming into force at the beginning of each stage would gradually develop their effects and bring about a change in economic reality so as to pave the way for the next stage. This evolutionary development would apply to both functional and institutional arrangements.

45. Parallelism. As has been argued in Part II, monetary union without a sufficient degree of convergence of budgetary policies is unlikely to be durable and could be damaging to the Community. Parallel advancement in economic and monetary integration would be indispensable to avoid imbalances which could cause economic strains and loss of political support for further developing the Community into an economic and monetary union. Perfect parallelism at each and every point of time would be impossible and could even be counterproductive. Already in the past the advancement of the Community in certain areas has gone hand in hand with temporary standstill in others, thus involving only partial parallelism. ~~A certain amount~~ Some of temporary deviations from parallelism is part of the dynamic process of the Community. But bearing in mind the need to achieve a substantial degree of economic union if monetary union is to be successful, and given the degree of monetary co-ordination already achieved, it is clear that material progress on the economic policy front is necessary for further progress on the monetary policy front. Parallelism would have to be maintained in the medium term ~~but~~ also before proceeding from one stage to the next.

x and 4 page 41

XX ~~46~~. Legal basis. The Committee has examined the scope for progress in economic and monetary integration under the present legal provisions in force in each member country. This investigation has shown that under present national legislations no member country is able to transfer decision-making power to a Community body, nor is it possible for many countries to participate in arrangements for a binding ex ante co-ordination of policies. [~~As a consequence, steps towards economic and monetary union would have to be confined to mutual surveillance, analysis of developments and non-binding co-ordination of policies.~~

~~More substantial~~ Steps, permitting collective decision-making - even on more limited operational matters - would involve changes in the institutional framework and, as has been pointed out earlier in this Report, necessitate a new Treaty.]

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

P40 +a
L32

64 in the 2nd March version of the Report

Para. ~~46~~ XX is a redraft of ~~old~~ para. 50, ~~proposed by the Rapporteurs.~~
Alternative text for old para. 50 suggested by Andriessen:

The Treaty

The Treaty of Rome, as amended by the Single Act lays down the basis for progress towards EMU. It is, however, insufficient for full realisation of EMU. There is at present no transfer of responsibility for economic and monetary policy from member states to the Community. The rules governing the EMS are based on informal agreements of self-restriction by the central banks concerned and are not an integral part of Community legislation. Without a new Treaty, steps towards EMU will be limited to non-binding co-ordination and strengthened co-operation. The process of integration based on a step-by-step approach requires, however, a clear understanding of its content and final objective, its basic functional and institutional arrangements and the provisions governing the gradual implementation. A new political and legal basis is accordingly needed from the outset. A new Treaty would establish not only the objective but also the stages by which it is to be achieved and the procedures and institutions required to move forward at each stage. Within this framework, the moves forward would take place on the basis of joint appraisals and assessments at each stage along the way. Political agreement would be required for each move to be implemented.

A new Treaty is also required to ensure parallel progress in the economic and in the monetary fields. The appropriate institutional and procedural arrangements to that effect should also be set out in the Treaty.

64 (Para. ~~48~~ xx) Pöhl suggests redraft (on the basis of old para. 50) of the ~~part~~ last sentence in brackets, to become a new paragraph:

As a consequence, one approach would be to provide for new concrete steps towards economic and monetary union that would initially be confined to measures designed to strengthen co-operation, mutual surveillance, analysis of current developments and prospects, and non-binding co-ordination of policies until such time when preparation and ratification of a new Treaty is considered appropriate. In the monetary field, the Committee of Central Bank Governors should be called upon to proceed accordingly; in the economic field, the existing Community institutions would be instructed likewise. A new Directive by the Council would define the objectives to be pursued and the detailed steps to be taken without institutional change.

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 by the Council, the Commission and the European System of Central Banks in the light of the experience made in the preceding stage. However, there should be a clear indication of the timing of the first stage, which would start no later than 1st July 1990 when the Directive for the full liberalisation ~~of capital movements comes into force.~~

Moreover, ~~On the other hand,~~ a firm political commitment to the final stage, as described in Part II of the Report, would appear to be an indispensable precondition for lending credibility to the decision to embark on the first stage. The strongest expression of such a commitment, ~~would be a~~ the decision by the highest political authorities to enter ~~[immediately]~~ into negotiations concerning the drafting of a new Treaty, would be

48. <u>Participation</u>. There is one Community, but not all the members have participated fully in all its aspects from the beginning. ~~So far this has mainly been the consequence of successive enlargements and, for the EMS, the fact that some countries have not yet taken the decision to join the exchange rate mechanism.~~ [A consensus on the final objectives of the Community, as well as participation in the same set of institutions, should be maintained, while allowing for a degree of flexibility concerning the date and conditions on which some member countries would join certain arrangements. Pending the full participation of all member countries - which is of prime importance - the management of each set of arrangements would have to be the responsibility of those who participate fully in it. However, this management would have to keep in view the need to facilitate the integration of the other members.]

2. <u>The ecu</u>

49. The Committee investigated various aspects of the role that the ecu might play in the process of economic and monetary integration in Europe.

50. Firstly, the Committee examined the role of the ecu in connection with an eventual move to a single currency. Although a monetary union does not necessarily require a single currency, political and psychological

- 30 -

to para 42

✓ P28 + a
L27.5

(Para. 4~~7~~2, 2nd sub-para.) <u>Leigh-Pemberton</u> suggests redraft of second sub-para. of para. 4~~7~~2:

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 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.

(Para. 4~~7~~2, last sentence) <u>Hoffmeyer</u> (supported by <u>Doyle</u>) suggests to replace last sentence of para. 47 by:
It would be a strong expression of such a commitment if all members of the Community became full members of the EMS in the course of stage one and undertook the obligation to formulate a convergent economic policy within the existing institutions. Similarly, it would be highly significant if the political authorities in good time before entering stage two committed themselves to enter into negotiations of a new Treaty.

(Para 4~~7~~2, 2nd sub-para.) ~~Addition between brackets suggested by~~ <u>de Larosière</u> suggests to amend the last sentence to read: "... to enter <u>immediately</u> into negotiations ...".

(Para. 48) <u>Doyle</u> ~~suggests to insert before the sentence starting~~ with "Pending ..." the following text:

x a

47

P29 L54.5 ✓

Tina, please align with para 48!

Nevertheless, an undertaking to participate in the exchange rate mechanism of the EMS by a specified date should be given at the time when member states formally commit themselves to the objective of economic and monetary union.

(Para ~~48~~ 47) <u>Alternative text proposed by Leigh-Pemberton</u>:
The Committee therefore considered the possibility that some member states might take institutional steps in the direction of EMU before others were able to do so. It formed the unanimous opinion that any such discriminatory approach, which would in any event have to be outside the framework of the Treaty of Rome, would be divisive and would put at risk the existing fabric of the European Communities.

~~(Section 2) The section on the ecu has been redrafted in the light of comments received in writing and the suggestions made at the last meeting.~~

reasons suggest that a single currency would be a desirable feature of a monetary union. The Committee was [of the opinion that the ecu has the potential to] be developed into such a common currency. This would imply that the ecu ~~as~~ a basked of currencies would be transformed into a genuine currency. Private agents should be assured that there ~~would be no~~ discontinuity between the present ecu and the single currency of the union and that ecu obligations would be payable at face value in ecu if the transition to the single currency had been made at the time of the maturity of the contract. from

51. Secondly, the Committee considered the possibility of adopting a parallel currency strategy as a way to accelerate the pace of the monetary union process. According to this approach the definition of the ecu as a basket of currencies would be abandoned at an early stage and the new fully-fledged currency, called ecu, would be created autonomously and issued in addition to the existing Community currencies. The new ecu would be a parallel currency in the sense that it circulated alongside national currencies and competed with them. The proponents of this strategy expect that the gradual crowding-out of national currencies by the ecu would make it possible to circumvent the institutional and economic difficulties of establishing a monetary union. The Committee felt that this strategy is not to be recommended for two main reasons. Firstly, an additional source of money creation without a precise linkage to economic activity could jeopardise price stability. Secondly, the addition of a new currency, subject to an independent monetary policy, would further complicate the already difficult endeavour of co-ordinating different national monetary policies.

52. Thirdly, the Committee examined possibilities for using the official ecu as an instrument in the conduct of a common monetary policy. The main features of a possible scheme ~~in this direction~~ are described in the Annex. [A number of members of the Committee felt that such a proposal might be one possible way of preparing the ground for a common monetary policy in the course of the second stage. Other members of the Committee felt this was neither adequate nor appropriate as a solution to the problem of ensuring equivalent monetary policies in the diverse monetary frameworks of ~~twelve~~ the member states.]

P30 L30.5

(Para. ~~50~~ 49) Ciampi ~~: see remarks on para. 24~~. notes that at the February meeting agreement had been reached on the formulation "the ECU should develop..." instead of "the ECU has the potential to develop...".

~~(Para. 52) Leigh-Pemberton suggests wording between brackets.~~

there should not be discrimination against the

53. Fourthly, the Committee agreed that voluntary use of the ecu by the private sector ~~should not be discriminated against~~ and that existing obstacles should be removed.

3. The principal steps in stage one

54. Stage one represents the entry into the process of creating economic and monetary union. It would aim at a greater convergence of economic performance through the strengthening of economic and monetary policy co-ordination within the existing institutional framework. It would ~~also~~ involve the preparation of a new Treaty which would provide the necessary basis for implementing stage two.

55. In the economic field the steps would centre on the completion of the internal market and the reduction of existing disparities through programmes of budgetary consolidation for countries concerned and more effective structural and regional policies. In particular, there would be action in three directions.

Firstly, there would be a complete removal of barriers within the Community, according to the internal market programme. The completion of the internal market would be accompanied by a strengthening of Community competition policy.

Secondly, the reform and doubling of the structural funds would be fully implemented in order to enhance the ability of Community policies to promote regional development and to correct economic imbalances.

~~[Thirdly, the 1974 Council Decision on economic convergence would be replaced by a new procedure that would considerably strengthen the possibilities for constraining budgetary imbalances, as well as for assessing the consequences and the consistency of the overall policies of the member states. [Co-ordination would be based on recommendations and carried out taking due account of the views of the Committee of Governors.]~~ In particular, the revised 1974 Decision on convergence would:

- establish a process of multilateral surveillance of economic developments and policies based on agreed indicators. Where performances are judged inadequate or detrimental to commonly set objectives, recommendations and policy consultations would take

- 32 -

→ (A) – from p 34

~~(Para. 55, 4th sub-para. starting with "Thirdly...") Doyle suggests to amend first sentence as follows:~~

Thirdly, the 1974 Council Decision on economic convergence would be replaced by a new procedure that would considerably strengthen economic and fiscal policy co-ordination and would, in addition, provide a comprehensive framework for an assessment of the consequences and consistency of the overall policies of member states. On the basis of this assessment, recommendations would be made aimed at achieving a more effective co-ordination of economic policies, taking due account of the views of the Committee of Governors. The task of economic policy co-ordination should be the primary responsibility of the ~~ECOFIN~~ Council of Economic and Finance Ministers (ECOFIN), whose discussions would be prepared by the Committee of Governors ~~and~~ the Monetary Committee and the Commission.

Consistency between monetary and economic policies would be facilitated by the attendance of central bank governors at appropriate Council meetings.

(Para 55, 4th sub-para., second last sentence starting with "Co-ordination ...") Ciampi points out that there is a risk of encroaching on the competences of other bodies.

place at the Community level with the aim of promoting the necessary corrections in national policies;

- set up a new procedure for budgetary policy co-ordination, with increasingly precise quantitative guidelines and medium-term orientations;
- [provide for the possibility of promoting, where deemed appropriate, concerted budgetary action by the member countries.]

~~(Para 55, 3rd indent) Leigh-Pemberton suggests to omit the tiret between brackets.~~

56. In the monetary field focus would be placed on removing all obstacles to financial integration and intensifying co-operation and co-ordination of monetary policies. In this connection consideration could be given to extending the scope of central banks' independent actions ~~[is this possible under the constraint of unchanged legislation?]~~. Realignments of exchange rates would still be possible, but an effort would be made by every country to make the functioning of other adjustment mechanisms more effective. Actions would develop along several lines.

P33 L18.5

Firstly, through the approval and enforcement of the necessary Community Directives, the objective of a single financial ~~space in~~ area which all monetary and financial instruments circulate freely and banking, securities and insurance services are offered uniformly throughout the area would be fully implemented.

55

Secondly, [it would be important to include all Community currencies in the EMS exchange rate mechanism.] The same rules would apply to all the participants of the exchange rate mechanism.

(Para 56, 3rd sub-para.) Pöhl and Doyle suggest to rephrase the sentence between brackets:
"all Community currencies should be included in the EMS exchange rate mechanism".

Thirdly, all impediments to the private use of the ecu would be removed.

Fourthly, the 1964 Council Decision defining the mandate of the Committee of Central Bank Governors would be replaced by a new Decision giving the Committee greater prominence and a stronger voice in the economic policy making process of the Community and its member states. To this end, the Committee of Governors would:

- formulate ~~[recommendations]~~ opinions on the overall orientation of monetary and exchange rate policy, as well as on measures taken in these fields by individual countries. In particular, the Committee would be consulted in advance of national decisions on

~~(Para. 56, 1st indent) Pöhl suggests to replace "recommendations" by "opinions".~~

opinions

the course of monetary policy, such as the setting of annual domestic monetary and credit targets;

- ~~make~~ policy ~~recommendations~~ to individual governments and the Council of Ministers on policies that could affect the internal and external monetary situation in the Community, especially the functioning of the EMS. The outcome of the Committee's deliberations could be made public by the Chairman of the Committee;

express

- submit an annual report on its activities and on the monetary situation of the Community to the European Council and the European Parliament.

The Committee's opinions ~~and recommendations~~ would not have to reflect unanimity and would not be binding. [In order to make its policy co-ordination function more effective, the Committee would appropriately strengthen the research and advisory rôle of three sub-committees and provide them with a permanent research staff:]

- a monetary policy committee would define common surveillance instruments, propose harmonised objectives and instruments and help to gradually induce a change-over from ex post analysis to an ex ante approach to monetary policy co-operation;
- a foreign exchange policy committee would monitor and analyse exchange market developments and assist in the search for effective intervention strategies;
- an advisory committee would hold regular consultations on matters of common interest in the field of banking supervision, policy.

X

The responsibilities and procedures of the Monetary Committee would be enhanced in parallel with the Committee of Central Bank Governors.

57. ~~In the institutional field this stage would involve the preparation and ratification of the Treaty on the economic and monetary union, with a procedure similar to the one followed for the Single European Act.~~

(Para. 56, 6th sub-para.) Alternative wording to the part between brackets proposed by de Larosière:

The members of the Committee of Governors have decided to reinforce the existing committees of experts and to support them by a permanent research staff. It is therefore essential at this very first stage to create an appropriately strong research structure and advisory function in the fields of monetary policy, foreign exchange policy and banking supervision.

P31 L44

A to page 32

(Para 53), last sentence.

(~~Para 57~~) Leigh-Pemberton suggests deletion or redrafting:
"In the institutional field, by the time of transition to stage two, it would be necessary to prepare and ratify the Treaty".
(~~Para. 57~~) Pöhl suggests to add at the end:
at a time to be decided in the light of progress made in the integration process in stage one.

58. A number of Committee members advocated the creation of a European Reserve Fund (ERF) that would foreshadow the future European System of Central Banks. The main objectives of the ERF would be:

- to serve as a training ground for implementing a better co-ordination of monetary analysis and decisions;
- to facilitate, from a Community point of view, the concerted management of exchange rates and possibly to intervene visibly (in third and participating currencies) on the foreign exchange market upon request of the participating central banks;
- to be the symbol of the political will of the European countries and therefore reinforce the credibility of the process towards economic and monetary union.

The resources of the Fund would be provided by a pooling of a limited amount of reserves (for instance 10% at the start) by participating central banks and require a permanent structure and staff in order to achieve its tasks, i.e.:

- management of the pooled reserves;
- interventions on the exchange markets decided by the members;
- analysing, from a collective perspective, monetary trends in order to enhance policy co-ordination.

All EC central banks would be eligible to join the Fund. However, membership would be subject to their participation in the exchange rate mechanism, the reason being that the EMS implies specific constraints on monetary policy and foreign exchange interventions that both require a common approach of the central bank concerned.

The management of the ERF would consist of:

- a Board of Directors which would comprise automatically the Governors of each central bank participating in the ERF;
- an Executive Committee whose members would be selected by the Committee of Governors on the basis of competence. This Executive Committee would be of a small size, consisting of three or four

~~(Para 58) Leigh-Pemberton suggests deletion of full para. or shortening it to include only the first twelve lines.~~

members who would have direct responsibility for the different departments of the ERF;

- the three Committees: a Foreign Exchange Policy and a Monetary Policy Committee and a committee on banking supervision ~~,~~ policy; X
- two departments: a Foreign Exchange and Reserves Management Department, and a Monetary Policy Department.

59. Other members of the Committee felt that the creation of a ERF was not opportune at this stage. Their reservations stem from the fact that:

- too much emphasis is placed on external considerations; common interventions by such a Fund cannot be a substitute for economic adjustment to correct imbalances within the Community;
- the proposal involves an institutional change which, in accordance with Article 102A of the amended Treaty of Rome, would fall under the procedure stipulated in Article 236 and require a new Treaty; the setting-up of the Fund under the same procedures as were applied to the establishment of the EMS are not considered possible;
- they consider that some functions of the Fund could be performed by the Committee of Governors if it were given wider powers; thus, there is no need to set up immediately a new institution;
- ~~[~~ what in the view of these members is essential is co-ordination of intervention policies rather than the technique of common interventions. This co-ordination can provide the necessary training ground while avoiding the unnecessary complication caused by instituting an additional intervention window. ~~]~~

~~(Para. 59, last indent) Wording proposed by Duisenberg; very similar wording proposed by Pöhl.~~

4. The principal steps in stage two

60. The second stage could begin only when the new Treaty had come into force. ~~[For essentially two reasons it is difficult to describe already now in precise detail the steps which will have to be taken in this stage. Firstly, there are some basic technical problems in designing steps when the final authority over decision-making rests with national authorities; secondly, the type of concrete measures to be implemented in~~

~~(Para. 60) Idea expressed by the part between brackets was suggested by Lamfalussy.~~

(B) from p 39

~~this stage will depend to a significant extent on what will have~~ been ~~achieved in the preceding stage.]~~ Stage two must ~~therefore~~ be seen as a period of transition to the final stage and is thus characterised primarily by a training process leading to a collective decision-making, but without yet abandoning the ultimate responsibility for policy decisions at the national level. ~~[If stage two were conceived to last for a long period or if it were enacted without a clear understanding regarding a subsequent move to full economic and monetary union, the provisions of stage two would have to be designed differently.]~~

The precise operating procedures to be applied in stage two would be developed in the light of the prevailing economic conditions and the experience gained in the previous stage.

(Para 60) Leigh-Pemberton suggests to delete the sentence between brackets.

61. In the economic field ~~the Council, the Commission and~~ the European Parliament would reinforce their action along three lines.

The Council of Ministers, the Monetary Committee and the Commission, ~~being ... on the ... Treaty,~~ ... be

Firstly, with regard to the single market and competition policy the results attained through the implementation of the single market programme would be reviewed and, wherever needed, made more effective.

Secondly, an evaluation of the performance of structural and regional policies would be made and a new programme would be adopted. [The resources for supporting the structural policies of the member states would be enlarged. Community investment programmes in research and infrastructure would be strengthened.]

(Para 61, 2nd sub-para.) ~~Leigh-Pemberton suggests to delete the sentence between brackets.~~

and enlarged on the basis of the new Treaty.

Thirdly, in the area of macro-economic policy, the provisions set up in the first stage through the revision of the 1974 Decision on convergence would be further strengthened ~~by the adoption of~~ guidelines would be adopted ~~decided~~ by a majority. Under this procedure the Community would:

Pöhl

- set a medium-term framework for key economic objectives with a follow-up procedure for monitoring performances and intervening when significant deviations occurred;
- set progressively more precise - although not yet binding - rules relating to the size of budget deficits and their financing; [the Commission should have the responsibility to bring before the Council any non-compliance by member states and should propose action as necessary;]
- assume a more active role as a single entity in the discussion of questions arising in the economic and exchange rate field, on the basis of its present representation (through the member states or

(Para 61, 2nd indent) Addition between brackets suggested by Pöhl and Duisenberg.

the Commission) in the various fora for international policy co-ordination.

62. In the monetary field the European System of Central Banks - having all the principal features described in Part II of the Report - would be set up and would absorb the previously existing institutional monetary arrangements (the EMCF, the Committee of Governors, the sub-committees for monetary policy analysis, foreign exchange policy and banking supervision, and the permanent Secretariat). The most important feature of this stage would be that the functions of the ESCB in the formulation and operation of a common monetary policy would gradually evolve as experience was gained. Exchange rate realignments would not be excluded as an instrument of adjustment, but there would be an understanding that they would be made only in exceptional circumstances and that the frequency and the extent of realignments should be steadily reduced. Some possible schemes for co-ordinating monetary policies in the course of this stage are discussed in the Annexes to the Report.

in the following ways:

Initially the ESCB framework would be used as a joint facility to be shared by national central banks for implementing national monetary policy through operations in domestic and foreign exchange markets; as a centre for monitoring and analysing domestic monetary conditions and foreign exchange market developments; as a centre for the co-ordination of national monetary policies.

[In addition, a number of actions would be taken in stage two.

Thirdly [~~Firstly~~, a certain amount of exchange reserves would be pooled and would be used to conduct limited exchange market interventions in accordance with guidelines established by the ESCB Council. Such guidelines would be determined by majority voting according to rules to be specified.]

Firstly ~~Secondly~~, general monetary targets would be set for the Community as a whole, with an understanding that national monetary policy would be executed in accordance with these global guidelines. The general monetary targets would be set by the ESCB Council on the basis of a majority decision. Secondly

~~Third~~ly, while the ultimate responsibility for monetary policy decisions would remain in the hands of national authorities, the operational framework necessary for deciding and implementing a common monetary policy would be created and experimented with. In this context

- 38 -

Tina, please change order in accordance with thirdly ... firstly ...

to p38 L12.5

follow L12.5

L32

60

(Para 62, 3rd sub-para.) Pöhl suggests complete deletion of the rest of the paragraph (starting with "In addition, ...").

60

(Para 62, 4th sub-para.) Duisenberg suggests the deletion of the sub-para. between brackets (starting with "~~Firstly~~ Thirdly, ...").

60

(Para 62, 3rd sub-para.) Thygesen (supported by Ciampi) suggests redraft starting with "In addition, ..."):

In addition, a certain number of actions would be taken in stage two. They would be designed to give the new institution visible means of influencing the overall rate of money and credit expansion in the participating countries as well as the ability to conduct limited exchange market interventions against third currencies. They would also comprise the attribution of regulatory functions to the ESCB in the monetary and banking field in order to achieve minimum harmonisation of provisions such as reserve requirements or payments arrangements that are necessary to the conduct of a common monetary policy.

Intermediate monetary objectives would be set for the Community as a whole, derived from the ultimate objective of medium-term price stability, and underpinned by objectives for national contributions to aggregate money creation and a presumption that participating central banks would refrain from offsetting the monetary consequences of interventions in other participating currencies.

Incentives for individual central banks to stay close to commonly agreed objectives would be provided through a mechanism which would sanction deviations. This could be done most directly and with the prospect of gradual evolution towards collective monetary control in stage three, by linking the money creation by each central bank to its ability to satisfy reserve requirements vis-à-vis the ESCB in analogy to one method by which national central banks exert influence on the rate of credit expansion of their banking system.

Various methods of applying such a system to the capacity of national central banks to create money are explored as illustrations in the Annex. They all rest on the basic notion that the ESCB would be in a position to control fully the supply of the asset which the central banks have to hold to meet the reserve requirements. This asset could take the form of a unit, defined as the present ecu; it would be supplied by the ESCB in quantities matching the demand for reserves which would arise, if each country followed its collectively targeted rate of money or credit expansion. The interest rate on the reserve asset would reflect the degree of scarcity of required reserves which the ESCB wishes to produce. The system might subsequently be extended to apply to individual banks, but in stage two could be confined to the relationship between the ESCB and the central banks.

The advantage of attributing an instrument of this type to the ESCB is that it would give focus to the operational efforts of the new institution. It would introduce in a limited, but significant sphere, a hierarchy in the relations of the ESCB to the component central banks while respecting the autonomy of the latter in managing their respective short-term instruments to preserve interest differentials conducive to exchange market stability.

for example, issue

~~ecus issued by~~ the ESCB could ~~be used as~~ issue reserve instruments. ~~The decision on the amount of ecu reserves to be issued could be made~~ on the basis of a majority decision. ~~But~~ Under such an ~~the~~ experimental scheme the minimum reserve requirement would not be compulsory. ~~This scheme is described in greater detail in the Annex to this Report.~~

Fourthly, regulatory functions would be exerted by the ESCB in the monetary and banking field in order to achieve a minimum harmonisation of provisions (such as reserve requirements or payments arrangements) necessary for the future conduct of a common monetary policy.

Fifthly, the margins of fluctuation within the ERM would be narrowed as a move towards the final stage of the monetary union, in which they would be reduced to zero.]

(Para. 62, 7th sub-para.) Duisenberg suggests to add (before "Fourthly, ..."?):
Any majority decision by the ESCB presupposes action by member states to ensure that central bank governors in their position as members of the ESCB Council should act independent of their government.

this stage

~~63.~~ In ~~the institutional field~~ the basic organs and structure of the economic and monetary union would be set up in ~~accordance with the Treaty,~~ involving both the revision of existing institutions and the establishment of new ones. In ~~this context, it might be appropriate to rationalise the existing roles of the Monetary Committee and the Economic Policy Committee with respect to the Council of Ministers~~. The institutional framework would gradually take over operational functions, serve as the centre for monitoring and analysing macro-economic developments and promote a process of common decision-making, ~~although the ultimate policy responsibility would still remain in the hands of the national authorities. However,~~ as stage two ~~represents a learning process allowing the Community to gain experience with operating in a~~ new institutional setting and ~~to approach progressively the conditions of economic and monetary union~~, it would be ~~crucial that~~ involving certain operational decisions ~~were~~ made by majority. ~~[In order to ensure that this would not imply a relinquishment of national policy autonomy, the adoption of a majority decision would have to be confined either to the use of instruments whose impact on economic developments is negligible or to decisions which do not hinder national authorities.]~~

B

to p 36

~~(Para. 63) Leigh-Pemberton suggests to delete this sentence.~~

5. The principal steps in stage three

64. The final stage would commence with the move to irrevocably locked exchange rates and the attribution to Community institutions of the full monetary and economic competences described in Part II of this Report.

In the course of the final stage the national currencies would eventually be replaced by the ecu as the Community's sole currency.

65. In the economic field the transition to this final stage would be marked by three developments.

Firstly, there would be a further strengthening of structural and regional policies of the Community. Instruments and resources would be adapted to the needs of the economic and monetary union.

Secondly, the rules and procedures of the Community in the macro-economic and budgetary field would assume a binding character.

In particular, the Council of Ministers and the Commission, [under the control of the European Parliament,] would have the authority to take directly enforceable decisions, i.e.:

- to impose constraints on national budgets to the extent to which this is necessary to prevent imbalances that may threaten monetary stability;
- to make discretionary changes (through a procedure to be defined) in Community resources to supplement structural transfers to member states or to influence the overall policy stance in the Community;
- [- to decide discretionary changes (through a procedure to be defined) in the level of harmonised taxation rates;]
- to apply ~~some form of conditionality~~ to existing Community structural policies and to Community loans (as a substitute for the present medium-term loans facility) terms and conditions that prompt member countries to intensify their adjustment efforts.

(Para. 65, 4th sub-para.) Amendment in brackets suggested by Pöhl.

(Para. 65, 3rd indent) Leigh-Pemberton suggests to omit the tiret between brackets.

Thirdly, the Community would assume its full role in the process of international policy co-operation and a new form of representation in arrangements for international policy co-ordination and in internal monetary negotiations would be adopted.

66. In the monetary field the irrevocable locking of exchange rates would come into effect and the transition to a single monetary policy would be made, with the ESCB assuming all its responsibilities as foreseen in the Treaty and described in Part II. In particular:

- concurrent with the announcement of irrevocable fixing of parities between the Community currencies, the formulation and implementation of monetary policy in the Community would be transferred to the ESCB, with its Council and Board exercising their statutory functions;
- decisions on exchange market interventions in third currencies would be made under the sole responsibility of the ESCB Council in accordance with Community exchange rate policy; the execution of interventions would be entrusted either to national central banks or the European System of Central Banks;
- technical and regulatory work would be done to prepare the transition to the ecu as single currency of the Community.

The change-over to the single currency would take place during this stage.

~~67. In the institutional field there would be the full attribution of competences to Community institutions, as foreseen in the Treaty.~~

6. One or several Treaties

from page 29, i.e. old para 46

68. The Committee has not investigated in detail the possible approaches under which the objective of economic and monetary union and its implementation would be embodied in the new Treaty. There would be basically two options. One procedure would be to conclude a new Treaty for each stage. The advantage of this procedure would be that it would explicitly reaffirm the political consensus at each stage and would allow for modification of the form the following stage should take in the light of experience with the current stage. At the same time, this approach would be unwieldy and slow, it might not safeguard sufficiently the overall consistency of the process and it would carry the risk that progress in parallel between the monetary and non-monetary sides would not be respected. In any event, if this procedure were chosen it would be crucial that the first Treaty laid down clearly the principal features of the ultimate objective of economic and monetary union.

69. Alternatively, it could be decided to conclude a single comprehensive Treaty formulating the essential features and institutional arrangements of economic and monetary union and the steps in which it could be achieved. Such a Treaty should indicate the procedures by which the decision would be taken to move from stage to stage. Each move would require an appraisal of the situation and a decision by the European Council.

p41 L27.5

7. Suggested follow-up procedure

(Section 7) Text proposed by Duisenberg (a very similar proposal has also been made by Pöhl).

70. If the European Council can accept this report as a basis for the further development towards economic and monetary union, the following procedure is suggested.

71. The Council and the Committee of Governors are invited to take the decisions necessary to implement the first stage.

72. The competent Community bodies are invited to make concrete proposals on the basis of this Report concerning the second and the final stage, to be subsequently embodied in a revised Treaty. These proposals should contain a further elaboration and concretisation where necessary of the present Report. They should serve as the basis for future negotiations on a revised Treaty in an intra-governmental conference to be called for by the European Council.

73. In following this procedure, negotiations on a revised Treaty will take place on a basis which will [already have been agreed as far as possible in substance by] those immediately responsible in member countries. At the same time, progress in policy co-ordination in the first stage as well as implementation of the internal market is allowed to create a momentum favourable for the negotiations.

74. The decision to let the revised Treaty come into force will be taken with due regard to the results achieved in the first stage.

L41

69-70

(Paras. 72-73) Ciampi proposes to amend these paras. to make the procedures more direct.

(Para. ~~72~~ 69) de Larosière suggests redraft:

Simultaneously it is decided to launch a negotiation on a revised Treaty in an intra-governmental conference to be called for by the Heads of State. In the framework of this negotiation, the competent Community bodies will make concrete proposals on the basis of this Report concerning the second and the final stage. These proposals will be embodied with the appropriate legal considerations in the revised Treaty.

(Para. ~~73~~ 70) de Larosière suggests to replace the part in brackets by "involve".

p42 L8

71

(Para. 74) Ciampi suggests omission.

- Amendments incorporated !
- Drafting suggestions made at last meeting that noted in previous draft (at the end)

Comments

I. The present state of and perspectives for economic and monetary integration in the Community

1. Introduction

Ciampi: Limit Part I to limited purpose, not too much detail on the historical origin of the present unification endeavour

omissions, repetition, shortening in 4, 7, 11, 13-18

1. Efforts in the Community to progress towards full economic and monetary integration began in earnest as the Bretton Woods system was breaking up. The Werner Report on the realisation by stages of economic and monetary union was drawn up in 1970. This initiative took place against the background of the major achievements by the Community in the 1960s: the completion of the transition period leading to customs union, the setting up of the common agricultural policy and the creation of a system of own resources. The Werner Report presented a first attempt to define and set out a plan for the attainment of economic and monetary union.

Pöhl

Several important ~~institutional~~ moves followed the Werner Report: in 1972 the "Snake" was created; in 1973 the European Monetary Co-operation Fund (EMCF) was set up; and in 1974 the Council Decision on the attainment of a high degree of convergence in the Community and the Directive on stability, growth and full employment were adopted. Yet, by the mid-1970s the perception had grown that the process of integration had lost momentum under the pressure from the divergent policy reactions to the economic crises occurring at the time.

2. In 1979 the process of monetary integration was relaunched with the creation of the European Monetary System (EMS) and the ecu. The success of the EMS in promoting its objectives of internal and external monetary stability laid the foundations for the new impetus to European integration in recent years, as reflected in the adoption, in 1985, of the internal market programme and the signing of the Single European Act.

~~The fact that the internal market process is now well under way proves~~ that the Community has been able to overcome the serious problems of the 1970s and has coped with the enlargements resulting from the accession of new member countries. The idea of economic and monetary union has been revived now that the Community has put its house in order and resolved the most urgent budgetary and policy issues. The Community is once more progressing along ~~the path of economic and monetary integration~~.

Pöhl
no indications ___ is tackling (L-P)
de Larosière wants to keep para 2 ?

2. The European Monetary System and the adjustment of the European economy

3. The European Monetary System was created by a Resolution of the European Council followed by a Decision of the Council of Ministers and an Agreement between the participating central banks. The progress made by the Community in the 1980s towards price stability, growing monetary co-operation and greater economic integration owed much to the EMS.

4. Within the framework of the EMS the participants in the Exchange Rate Mechanism (ERM) have succeeded in creating a zone of increasing monetary stability while gradually relaxing capital controls. This achievement was particularly remarkable in a period in which the world economy was shaken by wide exchange rate fluctuations and tensions in trade relationships. The exchange rate constraint has greatly helped some ~~the~~ participating countries in gearing their monetary policy towards the objective of price stability, thereby laying the foundations for both a converging price performance at a low rate of inflation and the attainment of a high degree of exchange rate stability. The greater priority attached to a policy of monetary stability has promoted a moderation in cost increases in many countries and led to an improvement in the overall economic performance. Moreover, the reduced uncertainty about exchange rate developments and the fact that the parities of the participating currencies were not allowed to depart significantly from the fundamental economic factors have ~~facilitated and strengthened~~ intra-European trade, ~~even at times of severe economic difficulties and high unemployment~~.

Pöhl

The exchange rate constraint may have made this more difficult for some other countries, e.g. low inflation countries like Germany. (Pöhl)

protected against excessive exchange rate volatility, (Pöhl)

The EMS has served as the focal point for improved monetary policy co-ordination and provided a basis for multilateral surveillance within the Community. Its success is in part attributable to the willingness of countries to opt for a strong currency policy stance, but also to the flexible and pragmatic way in which the System has been managed. The EMS has evolved in response to changes in the economic and financial environment and on two occasions (Palermo 1986 and Basle/Nyborg 1987) its mechanism has been amended and improved without changing its institutional setting.

especially by the increasingly close cooperation between central banks. The System has also benefitted from the role assumed by the DM as an "anchor" for participants' monetary and intervention policies. (Pöhl)

New sub-para to be added → Pöhl

5. An important element in the launching of the European Monetary System was the creation of the ecu. In establishing the EMS, the European Council declared in 1978 that "a European currency unit (ecu) will be at the centre of the EMS". Apart from being used as the numeraire of the exchange rate mechanism and as a denominator for operations in both the intervention and credit mechanisms, the ecu serves primarily as a reserve asset and a means of settlement for EMS central banks. To fulfil this latter function a stock of official ecus has been created through revolving swap arrangements whereby participating central banks maintain 20% of their gold and dollar reserves with the European Monetary Co-operation Fund. Although it is an integral part of the EMS, and despite a number of measures to improve its usability, the ecu has ~~so far~~ played only a limited role in the operating mechanisms of the EMS.

By contrast, the ecu has gained remarkable popularity in the market place, where its use as a denomination for financial transactions has spread significantly. A wide set of ecu instruments is now available for investors, both at the short and at the long end of the market. In international banking the ecu is at present the sixth most important currency of denomination and it ranks fifth in international bond issues, with a 6% market share. ~~The growing use of the ecu reflects in part the interest of public sector borrowers in developing and tapping the market for ecu securities~~, but to an important extent it must also be attributed to the ecu's attractiveness as a means of portfolio diversification and as a hedge against currency risks. Moreover, the creation of an ecu clearing system two years ago, in which more than thirty commercial banks now participate, has contributed to the development and the liquidity of the ecu market. In the non-financial sphere, however, the use of the ecu for the invoicing and settlement of commercial transactions remains limited, covering at present only about 1% of the Community countries' external trade. ~~Nonetheless, opinion polls, especially among firms, tend to show an increasing interest in the potential uses of the ecu.~~

3. The Single European Act and the internal market programme

6. On the economic side, a "relaunching" of Europe began in the mid-1980s, supported by the success of the EMS. The central element in this process was the proposal, made in January 1985 by the Commission, to

de La: tone down developments regarding private ecu

→ for a number of reasons (Pöhl)
one reason is that compulsory intervention and the build-up of intervention balances to be settled in ECU has remained rather limited as central banks have increasingly recourse to intra-marginal intervention involving the use of partner currencies, especially the DM (Pöhl)

Community institutions (e.g. EIB) have played an important role in promoting the use of the ECU as a denominator for their debt instruments, as have public authorities of certain Community members, (Pöhl)

Pöhl

Pöhl: preferably delete the rest of this section.
L-P: rest could be omitted

realise the objective of a market without internal frontiers by 1993. The essence of the measures for the removal of physical, technical and fiscal barriers was set out in a White Paper, which specified the precise programme, timetable and methods for creating a unified economic area in which persons, goods, services and capital will be able to move freely. This objective, together with the necessary institutional steps, was embodied in December 1985 in the Single European Act which marked the first significant revision of the Treaty of Rome.

7. The Single European Act signalled three important changes in the Community's strategy for advancing in the integration process. Firstly, it incorporated an ~~institutional~~ reform aimed at establishing a faster, more efficient and more democratic decision-making process, which was considered to be indispensable for reaching the goal of a common unrestricted market. In particular, this reform extended the scope of qualified majority voting and thereby removed the constraints inherent in the permanent search for consensus which had hampered the decision-making process in the past and gave the European Parliament a greater role in the legislative process. Secondly, it greatly simplified the requirements of harmonising national law by limiting harmonisation to the essential standards and by systematic adoption of mutual recognition of national norms and regulations. This new approach to market integration represented a decisive and innovative move towards deregulation and lesser public sector intervention in economic activity. Thirdly, with the Single European Act the member countries reaffirmed - and recognised in the context of the Treaty of Rome - the need to strengthen the Community's economic and social cohesion, to enhance the Community's monetary capacity in the perspective of economic and monetary union, to reinforce the Community's scientific and technological basis, to harmonise working conditions with respect to health and safety standards, to promote the dialogue between management and labour, and to initiate action to protect the environment.

de La: omit 7 to 9, to lighten the text

Pohl

8. Considerable progress has been made over the last three years in implementing the internal market programme. This highlights a marked change of pace in approaching a unified market, as compared to the developments during the previous two decades.

The realisation of the internal market by 1993 involves the adoption of some 300 Directives. In view of the time required for them to be transposed into national legislation, the bulk of the Community's legislative work should be completed by the end of 1990. In three years the Commission has presented 90% of the proposals for the Directives concerned and the Council has adopted around one-half. Rapid and significant progress has been made in removing technical barriers relating to machines, materials, foodstuffs, public works and supply contracts, sea, air and road transport and in achieving mutual recognition of diplomas. The abolition of fiscal barriers and physical barriers has so far advanced less quickly. The most prominent, and certainly one of the most important, steps towards the single market is the Directive on the liberalisation of capital movements which ~~was adopted within six months and which~~ will come into force on 1st July 1990. Another step in the direction of greater financial integration was the adoption of the Directive establishing the freedom to provide insurance services for industrial risks. This Directive applies the principle of mutual recognition.

Pole

9. The creation of a single market is, however, not based solely on the elimination of physical, technical and fiscal barriers but also comprises an improved competition policy to avoid market segmentation through restrictive commercial practices and dominant market positions, as well as common policies aimed at complementing the working of market forces when they prove insufficient to achieve common goals in such areas as infrastructure, technological advancement, regional development and environment.

In the field of competition policy, the Commission's ability to apply Community law governing the internal market will be strengthened, various measures will be implemented to increase the transparency, efficiency and legal certainty of the procedures of the Community's competition policy and a court of first instance, specialising in particular in competition questions, will be established alongside the European Court of Justice.

As far as complementary common policies are concerned, the European Council approved in February 1988 a package of measures which dealt both with the most urgent and arduous European policy issues and Community policies directed at common goals and safeguarding the economic and social cohesion of the Community. The package included three major elements. Firstly, an adaptation of the common agricultural policy to the general conditions in the world market and to the need of preserving a diversified agricultural sector in Europe. Secondly, the adoption of a new financial regime which provides a firm footing for Community activities on the basis of a system of own resources. Thirdly, a considerable improvement in the Community's capacity to influence structural and regional developments in the single market. Most importantly, the structural funds will be doubled by 1993, which, together with a reorientation of policies away from project to programme financing, will enable the Community more effectively to promote growth and adaptation in less developed regions and a restructuring of declining industries. Moreover, with the adoption of a framework programme for research and technological co-operation the Community will be able to strengthen the scientific and technological foundations of European industry and help it to exploit the advantages of an enlarged market.

4. Perspectives, opportunities and problems

10. The European Council, meeting in Rhodes in December 1988, noted that "at the halfway stage towards the deadline of December 1992, half of the legislative programme necessary for the establishment of the large market is already nearly complete" and underlined "the irreversible nature of the movement towards a Europe without internal frontiers". There is, indeed, widespread evidence that the objective of a single market enjoys broad support by consumers and producers and that their economic decisions are increasingly influenced by the prospects of 1992. Anticipation effects are clearly reflected in the investment strategies of European firms and the unprecedented number of mergers foreshadowing growing industrial co-operation. These developments have generated a new dynamism and have contributed to the recent acceleration of economic growth in the Community.

11. The single market will entail profound structural changes in the economies of the member countries. The abolition of internal barriers will link national economies much more closely together and significantly increase the degree of economic integration within the Community. These changes offer immense opportunities for economic advancement but many of

L-P: not clear that Community has endorsed the objective; better omit

L-P better omit

de Lar: shorten para 10-18

L-P This section assumes that by end 92 the Community will be a fully integrated market and instability will need to be subject of urgent Community action beyond a point where voluntary cooperation will suffice. Change: suggest that member states will take many years to digest the volume of single market legislation, as will their economic structures. Community should not take any major steps now, but concede that the process of integration will lead to pressures for increasing coordination, some of which may possibly be lead from the centre

de Lar: para 11 is too optimistic

the potential gains can only materialise if economic policy - at both national and the Community levels - responds adequately to the structural changes. The opportunities arise because the unified enlarged economic space greatly increases the freedom of choice of market participants, raises their purchasing power, generates considerable possibilities for exploiting economies of scale and comparative advantages, reduces the administrative costs of intra-Community trade and enlarges the margins of manoeuvre for macro-economic policy. There can be no doubt that these changes prepare the ground for a more efficient use and allocation of resources with beneficial effects for trade, growth and employment. →

However, these benefits will accrue only if the single market remains open to competition within a global free trading system and avoids the creation of new barriers vis-à-vis third countries (Pöhl)

The extent to which these gains can be achieved depends critically on the degree of certainty as well as the soundness and consistency of the government policies affecting the decision-making of private market participants. The single market will greatly strengthen economic interdependence between member countries, reduce the room for independent policy manoeuvre and amplify the cross-border effects of developments originating in each member country. If national policies are not pursued in a credible and consistent manner the participants in the single market will be facing conflicting signals, which will not only create an unfavourable climate of uncertainty, but over time will give rise to economic imbalances which might necessitate more frequent exchange rate realignments or recourse to safeguard clauses. The existence of a common market and the desire to draw from it all its potential economic and social benefits thus necessitates ~~a~~ much [~~more intensive and effective~~ co-ordination of policy between separate national authorities. This is most obviously the case in the field of monetary policy, where freedom of capital movement and integrated financial markets would quickly translate incompatible national policies into exchange rate pressures. But it also applies to all other areas of national economic management which affect ~~aggregate demand and costs of production~~.

[greater and durable convergence of economic policies and their results. To this end coordination of policies between separate national authorities needs to be intensified further and thus be made more effective. Freedom of capital movement and integrated financial markets would quickly translate incompatible national policies into exchange rate pressures, while at the same time putting increasing burdens on monetary policies and their coordination between central banks. The need for more intensive and effective policy coordination extends to all areas of national economic management which affect aggregate demand, prices and cost of production, including monetary policy. (Pöhl)

Even close co-operation between national authorities, however, cannot ensure that the efficiency gains from a unified market will be evenly distributed among all member countries. Common policies conducted at the Community level in support of a broadly balanced development and an equitable distribution of prosperity are therefore an indispensable complement to a single market. Indeed, the need to back up the removal of market barriers by a strengthening of common regional and structural policies was clearly recognised in the Brussels package of measures agreed in February 1988.

case-by-case (Ciampi)

12. The success of the internal market programme thus hinges to a decisive extent on a much closer co-ordination of national economic policies, as well as on more effective Community policies. This implies that ~~in essence~~ a number of the steps towards economic and monetary union will already have to be taken in the course of establishing a single market in Europe. ~~It also implies that serious consideration should be given to the limits of voluntary co-ordination.~~ Policy decisions faced by national authorities in the economic as well as in the monetary field are subject to many pressures and institutional constraints so that even best efforts to choose a course of action mindful of international repercussions and influences are bound to fail at certain times. By giving unclear or contradictory signals to market participants and by generating divergent trends, a failure in co-operation would weaken the single market and create the danger of negative chain reactions. This is why entirely voluntary procedures would be too fragile a foundation to build on permanently for achieving the necessary degree of policy co-ordination.

L-P: not accepted that success of internal market programme hinges to a decisive extent on a much closer coordination ...

Pöhl

While voluntary cooperation should be relied on as much as possible to arrive at increasingly convergent national policies, thus taking account of diverse constitutional situations in member countries, there is also likely to be a need for more binding procedures (Pöhl)

L-P serious consideration should be given to the limits of voluntary coordination as progress is made towards EMU; the internal market programme itself does (in his view) give rise to such consideration

de Lar.: para 13-17 should be condensed to the main principles contained in them

13. As will be explained in Part II of this Report, an economic and monetary union encompasses a common market for persons, goods, services and capital, a single currency area and a set of arrangements designed to ensure a coherent and effective economic management for the Community as a whole. In this sense economic and monetary union will add two principal elements to the internal market programme. Firstly, it will explicitly set up a policy framework which will replace the present ad hoc procedures for voluntary policy co-ordination by a system defining clearly the distribution of policy responsibilities exercised at the Community and the national levels ~~and thereby guarantee~~ a consistent economic management. Secondly, it will create a single currency area through an irrevocable locking of exchange rates or the introduction of a single currency, and thereby ~~strongly~~ enhance the potential of the single market.

in such a manner as to (Pöhl) promote (L-P)

(L-P)

Although in many respects a natural sequence to the commitment to create a market without internal frontiers, the move towards economic and monetary union represents a quantum jump which would secure a significant increase in economic welfare in the Community. This would derive from three interrelated developments.

l-P para should be omitted

14. Firstly, the strengthening and expansion of common policies pursued at the Community level would help to correct market imperfections which operate on a Community-wide scale and could therefore not be satisfactorily dealt with at a national level. This applies to research and development, where Community policies would promote the pooling of resources, help to avoid duplication and facilitate the dissemination of information. Similarly, common industrial policies could prevent competition among national incentive schemes which, without a certain degree of intervention at the Community level, would tend to neutralise each other and lead to a waste of scarce economic resources. Large productivity gains for the Community as a whole could also be achieved by organising on a Community scale the provision of cross-border public goods such as infrastructure for transportation, the environment and long-distance energy transmission. Finally, and perhaps most importantly, the Community structural policies would help to develop a more balanced economic structure throughout the Community and thereby prevent the emergence or aggravation of regional and sectoral imbalances.

15. Secondly, a joint management of macro-economic policies is not only vital for the cohesion of an economic and monetary union, but it would also systematically enlarge the reciprocal room for manoeuvre that could be exploited under a co-operative strategy to attain a higher rate of growth and employment. Within a clearly defined framework for policy-making the interdependence of economic developments in individual member countries would be automatically taken into account and would thereby ensure the most favourable outcome from the interactions of national policies. ~~For instance, the Cecchini~~ Report ~~estimated that the impact~~ of the internal ~~market~~ programme on growth in the Community, which might be ~~in the order of 4½%, could be further~~ raised by 2½ percentage ~~points~~, if the removal of market barriers were accompanied by an active macro-economic policy in the Community. An economic and monetary union would greatly enhance the chances for implementing such a co-ordinated strategy.

Thus the impact of the internal market programme on growth in the Community could be further raised, (Pöhl)

16. Thirdly, in leading to a <u>single currency area</u> an economic and monetary union would establish the conditions under which a common market could fully develop its potential. In a single currency area participants in the single market would benefit considerably from three developments: exchange rate uncertainties with regard to intra-Community transactions would be eliminated, the cost of transactions between residents of different Community countries would be reduced and the <u>transparency of prices and, therefore, the pressure to avoid price discrimination would</u> be increased. These three consequences would not only provide greater certainty for economic decisions and planning, they would also strongly reinforce the competitive forces of a common market and enhance its allocative function. The existence of irrevocably fixed exchange rates would, moreover, dispel fears of a devaluation and market participants would cease to seek compensation for anticipated exchange rate depreciation in the form of higher wage claims or higher interest rates. As a consequence, cost pressures would be reduced and interest rates would converge in a downward direction. Finally, as a single currency area the Community would be much less susceptible to external economic shocks.

Oh lo: para 16 should be retained but perhaps shortened

(-P → handle this argument carefully; if it leads to equalisation of wages it would tend to cause unemployment in low productivity areas; price discrimination may sometimes be desirable

The adoption of permanently fixed exchange rates would, however, eliminate an important indicator of policy inconsistencies among Community countries and remove the exchange rate as an instrument of adjustment from the Community's set of economic tools. Economic imbalances among member countries, reflecting either a differing response of individual economies to disturbances from outside the Community, or divergent cost developments within the Community, would therefore have to be corrected by policies affecting ~~the structure of the economies and the costs of production~~, if major regional disparities in output and employment were to be avoided. The abandonment of the exchange rate instrument would constitute the single most significant change on the way to economic and monetary union,. ~~but~~ The effect of this change ~~would~~ could only be alleviated in an economic and monetary union ~~by the availability of common~~ Community policies and ~~a high degree~~ of ~~national~~ policy co-ordination. ~~Indeed,~~ As external shocks would normally not affect the entire economy of a single member country, but rather manifest themselves in specific sectors throughout the Community, ~~so that~~ the appropriate remedial action would be in the form of structural policies instead of exchange rate changes. Sizable imbalances among Community countries ~~would~~ could, however, ~~only~~ emerge if individual countries embarked on

domestic demand, prices and the cost of production as well as the structure of the economies (Pöhl) Pöhl

if appropriate use is made of

incompatible policy courses, ~~but this is precisely what should be impeded by moving from~~ ad hoc voluntary co-operation ~~to~~ the new set of rules, procedures and institutional arrangements that characterise ~~the~~ economic and monetary union are called for.

17. The move to economic and monetary union would considerably increase the Community's weight in the world economy, strengthen its role in international concertation and give it a substantial influence on the management of the world economy and the international monetary system. The Community's enhanced capacity for negotiation and action could make a significant contribution not only to greater stability in exchange and financial markets, but also to a high level of activity in the world economy, with beneficial effects for growth in Europe. The role of a European economic and monetary union in the context of the world economy will be ~~examined~~ in Part II of this Report.

18. Economic and monetary union has been set as a goal by the Community since the late 1960s. ~~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.~~ The establishment of the single market together with stepped-up policy co-ordination represents considerable progress along the path leading to an economic and monetary union. Both the desire to draw maximum benefits from the single market programme and the need to intensify economic and monetary co-operation have led the European Council in Hanover to give further consideration to the question of an economic and monetary union and the steps leading to it. In order to be able to set out such a step-by-step approach it is essential to define clearly the final objective. For this reason, the following part of this Report examines the principal features and implications of an economic and monetary union, including a description of the economic and institutional conditions under which it can be achieved. The subsequent part then presents a pragmatic step-by-step approach which could lead in three stages to the final objective.

which would no longer be manifested in balance of payments problems but in regional employment and growth differentials. Reliance on
may not suffice to prevent such developments and a

Pöhl

referred to (Pöhl)

L-P: omit!

L-P: make clear that the single market does not require EMU or a single currency and that the single market integration needs to be fully digested before the implementation of major steps towards ec. + mon. union

II. The final stage of economic and monetary union

1. General considerations

19. Economic and monetary union in Europe would imply complete freedom of movement for persons, goods, services and capital, as well as irrevocably fixed exchange rates between national currencies or a single currency. This, in turn, would presuppose a high degree of integration and require a common monetary policy and consistent economic policies. In the Community these policies would be geared towards price stability, balanced growth and converging standards of living, high employment and external equilibrium. Economic and monetary union would represent the final result of the process of progressive economic integration in Europe.

20. The Treaty of Rome, as amended by the Single European Act, provides the legal foundation for many of the necessary steps towards economic integration. However, the existing Treaty does not suffice for the creation of an economic and monetary union. The realisation of this objective would call for new arrangements which could only be established on the basis of a new Treaty and consequent changes in national legislations. For this reason the union would have to be embodied in a Treaty which clearly laid down the basic functional and institutional arrangements, as well as provisions governing their step-by-step implementation.

(–?): fuller treatment needed should go to end of Part II

21. Even with a single market, a unified monetary system and an institutional and functional framework for economic management, the Community would continue to consist of independent nations with differing economic characteristics, traditions, social customs and languages. The existence and preservation of this plurality and diversified structure would necessitate that a degree of autonomy in economic decision-making continued to rest with individual member countries and that a balance were struck between national and Community competences. For this reason it would not be possible simply to model an economic and monetary union for the Community on the example of existing federal states; it would be necessary to develop an innovative and unique approach.

An essential element of any approach consistent with the historical and economic conditions in member countries would be the distribution of economic policy responsibilities within the Community in strict conformity with the constitutional "principle of subsidiarity". According to this principle, the functions of higher levels of government should be as limited as possible and should be subsidiary to those of lower levels. Thus, the attribution of competences to the Community would have to be confined to those areas in which collective decision-making was necessary, whereas all policy functions which could be carried out at national (and local) levels without adverse repercussions on the cohesion and functioning of the economic and monetary union would have to remain within the competence of the member countries.

With due regard to the principle of subsidiarity and taking into account what is already provided for in the EC Treaties, the need for new policy functions to be taken at the Community level would arise primarily, though to a somewhat different extent, in the fields of monetary policy and macro-economic management. A monetary union would require a single monetary policy and the responsibility for the formulation of this policy would consequently have to be vested in one decision-making body. In the economic field a wide range of decisions would remain the preserve of national and local authorities acting through their traditional channels and instruments. However, given the impact that they might have on the overall domestic and external economic situation of the Community, and their implications for the conduct of a common monetary policy, such decisions would have to be placed within an agreed macro-economic framework and be subject to binding rules which ~~would enable the Community to determine an overall policy stance~~, avoid major differences between individual member countries in public sector borrowing requirements and ~~[illegible]~~ constraints ~~with regard~~ ~~to~~ the financing of budget deficits.

Cancel
L-P: omit this

to the purposes of the Community

Pöhl

put binding
on

22. A step-by-step approach to implementing an economic and monetary union can be set out only if there is a clear understanding and acceptance of the final objective, of its implications for the working of the economy and economic policy decisions, and of the principal elements that would have to be in place for its successful and durable functioning. Economic union and monetary union are closely intertwined, form two integral parts of a single whole and would therefore have to be implemented in parallel. It is for reasons of expositional clarity that the following sections look separately

at the principal features defining an economic and a monetary union. This description begins with the concept of a monetary union, chiefly because an economic union can be circumscribed more clearly and specifically once the main elements of a monetary union have been identified.

2. The principal features of monetary union

C-P would section on economic union precede section 2

23. A monetary union describes a single currency area in which policies are managed jointly with a view to attaining common macro-economic objectives. As already stated in the 1970 Werner Report, there are three necessary conditions for a monetary union:

- the assurance of total and irreversible convertibility of currencies;
- the complete liberalisation of capital transactions and full integration of banking and other financial markets; and
- the elimination of margins of fluctuation and the irrevocable locking of exchange rate parities.

The first two of these requirements - the convertibility of Community currencies and the creation of a free and fully integrated financial market - have already been met, or will be with the completion of the internal market programme. The basic conditions for a monetary union would, however, be accomplished only when the decisive step was taken to lock the exchange rates between Community currencies irrevocably. This would be the single most important step towards creating a situation in which all currencies could be used equally to set prices, make payments and denominate debts or credits.

As a result of the permanent fixing of exchange rates, national currencies would become increasingly close substitutes and their interest rates would tend to converge. However, the pace with which these developments took place would depend critically on the extent to which firms, households, labour unions and other economic agents were convinced that the decision to lock exchange rates would not be reversed. Initially, the continuing existence of national currencies might leave doubts about the commitment to unchangeable exchange rate parities and could engender market perceptions of differences between individual currencies' quality

K-P: This sub-para should 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 and standing. Both coherent monetary management and convincing evidence of an effective co-ordination of non-monetary policies would be crucial in dispelling such doubts over time.

24. The three above-mentioned requirements are necessary for the establishment of a single currency area, but their implementation would not necessarily mark the end of the process of monetary unification in the Community. At a later stage the adoption of a single currency, while ~~in principle~~ not strictly necessary for the creation of a monetary union, might be seen - for economic as well as psychological and political reasons - as a natural and desirable further development of the monetary union. A single currency would clearly demonstrate the irreversibility of the move to monetary union, considerably facilitate the monetary management of the Community and have a much greater weight ~~in international markets than any individual Community currency~~. ~~In this connection, it would be desirable~~ to ~~endorse the idea~~ that the present ecu should develop into the future currency of the Community, ~~and that an official declaration to this effect should be~~ made at the time of the decision to draw up a new Treaty. This declaration would imply that there should be no discontinuity between the present ecu and the future single currency: any debt contracted in ecus before the introduction of the single currency would have to be payable at face value in ecus if, at maturity, the transition to the single currency had been made. While the Treaty should allow for an appropriate period of transition, this would mean that ultimately the ecu would replace existing national currencies and perform all monetary functions for all residents of the Community. The replacement of national currencies by a single currency would take a certain time and require that economic agents had become sufficiently acquainted with the ecu and that its use in commercial and ~~financial transactions had spread~~.

L-P: no need to describe future of ecu in such detail; should be left to Part III

Pöhl

relative to other major currencies such as the US Dollar, Yen etc. than any individual Community currency. It is probably too early for a decision

The present basket ecu assumes the existence of its component currencies. Their disappearance would by definition also mean that the existing ecu would have to be replaced by a new abstract ecu at the time of transition to the common currency. In any case the transition would have to be made without discontinuity from the existing basket ecu if it were so decided. Adequate time would be required for economic agents to become acquainted with the new ecu and its characteristics. Pöhl

25. The establishment of a monetary union would have far-reaching implications for the formulation and execution of monetary policy in the Community. Once permanently fixed exchange rates had been adopted, but national currencies continued to exist in an environment of free and fully integrated capital and money markets there would be a need for a single monetary policy, to be carried out through new operational procedures and not simply through the co-ordination of as many national monetary policies

as there were currencies participating in the union. This, in turn, would require the attribution of responsibility for monetary policy to a new institution, the European System of Central Banks (the principal features of which are outlined in Section 4 below), which would not only form the basis for centralised and collective decisions on the ~~expansion~~ of money and credit in the Community, but would also possess the necessary financial attributes (i.e. its own balance sheet) and the regulatory powers to enforce implementation of the chosen policy. In designing the necessary operational framework, particular attention would thus have to be given to two essential requirements. Firstly, an agreement ~~would have to be reached~~ on a~~n~~ ~~unambiguous~~ procedure for ~~setting specific objectives~~ of the Community's aggregate monetary policy; and secondly, instruments would have to be developed ~~to ensure the compliance of national monetary authorities with the commonly taken decision~~.

This shift from national monetary policies to a single monetary policy is an inescapable consequence of entering a monetary union and would mark one of the principal institutional changes required by economic and monetary union. ~~In practice, however, the incision would not be so deep, but rather would represent the completion of~~ a progressively intensified co-ordination of national monetary policies~~, which had~~ would in many respects already ~~foreshadowed~~ the move to a single monetary policy ~~in the Community~~. ~~Even prior to the decision to fix exchange rates permanently, the~~ liberalisation of capital movements and financial market integration will create a situation in which the co-ordination of monetary policy will have to strengthen progressively. Once every banking institution in the Community is free to accept deposits from, and to grant loans to, any customer in the Community and in any of the national currencies, the large degree of territorial coincidence between the national central banks' area of jurisdiction, the area in which their currency is used and the area in which "their" banking system operates will be lost and the effectiveness of national monetary policies will become increasingly dependent upon co-operation among central banks. Indeed, the growing co-ordination of monetary policies will make a positive contribution to financial market integration and will help central banks to gain the experience that is necessary for moving to a single monetary policy.

L-P: Report does not ~~include~~ explore extent to which even a federal European System of Central Banks could be constructed in different ways; balance sheet not indispensable

supply (Pöhl)

determining (Pöhl)

for the implementation of the common monetary policy at national levels (Pöhl)

(L-P: instruments? Does this refer to institutions or market instruments?

Although

have prepared

Pöhl

The implications of such a move would be far-reaching. Together with the permanent fixing of exchange rates it would deprive individual countries of the principal instrument available to correct economic imbalances and act independently in pursuit of national objectives, especially price stability. This loss would be most intensely felt by those countries that had retained some room for manoeuvre to pursue stability objectives under the less binding EMS rules. (Pöhl)

L-P: para need to address question of external exchange rate policy; fixed or floating relationship with $?

Also: emphasise that not all weight must be placed on monetary policy; coordination of budgetary policies also important

26. In summary, the realisation of a monetary union would mean that in a situation of free capital movements and full financial integration the exchange rates between Community currencies would be irreversibly fixed. This would create a monetary union in which~~, at least initially,~~ all national currencies ~~circulated freely, although they~~ might eventually be replaced by ~~the Cou as the~~ sole Community currency. The transition from a situation of fixed but adjustable exchange rates to a system of permanently locked parities would imply a fundamental change in the economic as well as the monetary management of the Community. National monetary policies would have to give way to a single monetary policy for the Community as a whole, formulated and executed jointly in the context of a European System of Central Banks. At the same time, a single currency area would imply the abandonment of the exchange rate as an instrument of adjustment of imbalances among Community countries and would therefore require, in parallel to the process of monetary integration, measures to ~~co-ordinate effectively~~ policies in non-monetary areas.

become increasingly close substitutes for each other and (Pöhl)

effective in enforce (→ see previous remark

3. The principal features of economic union

27. Economic union combines the characteristics of an unrestricted common market with a set of rules which are indispensable for its proper working. In this sense economic union can be described in terms of four basic elements:

- the single market within which persons, goods, services and capital can move freely;
- competition policy and other measures aimed at strengthening market mechanisms;
- common policies aimed at structural and regional development; and
- macro-economic policy co-ordination, including binding rules for budgetary policies.

In identifying the content and limits of specific rules and arrangements defining an economic union, the Community should be guided by two considerations.

Firstly, the economic union should be inspired by the same market-oriented economy principles that constitute the foundation of the economic order of its member countries. Differences in policy choices may exist between member countries or - within the same country - in different periods. However, beyond such differences, a distinctive common feature of economic systems in Europe is the combination of a large degree of freedom for market behaviour and private economic initiative with public intervention in the provision of certain social services and public goods. Within this broad conception, the scope for attributing to the Community economic functions that are at present exercised at national levels should be limited by adherence to the principle of subsidiarity.

Secondly, an appropriate balance between the economic and the monetary components should be ensured for the union to be viable. This would be essential because of the close interactions between economic and monetary developments and policies. A coherent set of economic policies at the Community and national levels would be necessary to maintain permanently fixed exchange rates between Community currencies; and, conversely, a common monetary policy in support of a single currency area would be necessary for the Community to develop into an economic union.

Pöhl: delete this para

L-P: suggest redraft to make clear that a common monetary policy and a single currency are not necessary for economic union, though they may be desirable

28. The measures aimed at <u>creating the single market</u> are to a large extent envisaged in the Treaty of Rome and the Single European Act. With their implementation, by 1992, all barriers which tend to separate markets along national borders will be eliminated. In particular, all technical and regulatory obstacles will be removed, norms will be harmonised or mutually recognised, and certain common minimum standards governing social policy and consumer and environmental protection will be agreed. Moreover, national tax treatment will be partly harmonised to avoid severe distortion in the competitiveness of industries operating in different countries of the Community.

L-P: para 28 could be expanded to give greater detail on "soft" union, which goes beyond the single market as described here.
Much can be done, consistent with long-term goal of EMU, that goes beyond the completion of the legislative framework of the internal market.

The creation of a single market will impart strong impulses to economic growth and increase economic welfare through both a further specialisation in line with countries' and regions' comparative advantages and the exploitation of economies of scale in production, research and marketing. These gains will materialise as the residents in the enlarged market without internal frontiers respond to price, wage and interest rate movements, which, transmitted throughout the Community, will provide important incentives for better allocation of factors of production and for a more efficient use of economic resources. There is no doubt that this process will stimulate economic activity and employment in the Community as a whole, and will generate greater economic freedom and increased trade in goods and services.

29. As has been pointed out in Part I of this Report, the single market in combination with irrevocably fixed exchange rates or a single currency would have profound effects on the functioning and the performance of the economy of the Community.

Pöhl delete   L-P: This could begin a new section headed "EC + monetary union"

A monetary union would further enhance the advantages of an enlarged economic space because it would remove exchange rate uncertainties and lower transactions costs, eliminate the possibility of movements of exchange rates unwarranted by fundamental factors, contribute in the longer run to the evolution of a more homogeneous economic structure in the Community and reduce the susceptibility of the Community to external shocks.

At the same time, however, exchange rate ~~realignment~~ would no longer be available as an instrument to correct economic imbalances. Such imbalances might arise because the process of adjustment and restructuring set in motion by the removal of physical, technical and fiscal barriers is unlikely to run smoothly or always produce satisfactory results within reasonable periods of time. Imbalances might also emanate from labour and other cost developments in one member country, external shocks with differing repercussions on individual economies, or divergent economic policies pursued at national levels.

adjustment (Pöhl). L-P: this ignores the possibility of an ex. rate change vis-à-vis third currencies

within the Community,

With parities irrevocably fixed, foreign exchange markets would cease to provide a source of pressure for policy corrections when economic disequilibria developed and persisted. Moreover, the statistical measurement and the economic interpretation of economic imbalances might become more difficult because in a fully integrated market balance-of-payments figures, which are currently a highly visible and sensitive indicator of economic disequilibria, would no longer play such a significant role as a guidepost for policy-making. Nonetheless, such imbalances ~~would have to be detected and eliminated rather quickly,~~ or ~~their emergence be avoided altogether, in order to make it possible to reap the benefits of economic union without undue costs~~ in the form of ~~marked~~ pressures on output and employment ~~in certain regions of the Community~~.

L-P   national

L-P: argument difficult to follow: market would finance what would previously have been regarded as big deficits.

if left uncorrected would manifest themselves as regional imbalances

~~The balance between the economic benefits and costs of exchange rate fixity would become more and more favourable as the Community developed into an economic and monetary union~~. In order to tilt the balance in this direction it would be essential that the move towards monetary union should be coupled with measures designed to strengthen the mobility of factors of production and a close co-ordination of economic policies.

Measures designed to strengthen the mobility of factors of production would be one way to deal with such imbalances (Pöhl)

30. The creation of an economic and monetary union would need to complement the single market through action in three interrelated areas: competition policy and other measures aimed at strengthening market mechanisms; common policies to enhance the process of resource allocation in those economic sectors and geographical areas where the working of market forces needed to be reinforced or complemented; macro-economic co-ordination, including binding rules in the budgetary field and other arrangements both to limit the scope for divergences between member countries and to design an overall economic policy framework for the Community as a whole.

L-P: these difficulties are more acute, if move to EMU in a situation of divergent performances

31. Competition policy - conducted at the Community level - would have to operate in such a way that access to markets would not be impeded and market functioning not be distorted by the behaviour of private or public economic agents. Such policies would have to address conventional forms of restrictive practices and the abuse of dominant market positions, but would also have to deal with new aspects of antitrust laws, especially in the field of merger and takeover activities. I~~n addition, attention would have to be paid to excessive~~ government subsidies to ~~the extent to which the~~y distorted competition ~~or resulted in the longer run in~~ an inefficient use and allocation of scarce economic resources.

The use of / assist particular industries should be strictly circumscribed because they / and cause

32. Community policies in the regional and structural field would be of paramount importance, in order to promote an optimum allocation of resources and to spread welfare gains throughout the Community. Without adequate consideration for regional imbalances, the economic union would be faced with grave economic and political risks. For this reason particular attention would have to be paid to an effective Community policy aimed at cushioning regional and structural disparities and promoting a balanced development throughout the Community. In this context the regional

L-P: not all countries regard resource transfer as a solution to these problems
"paramount importance" not accepted by all countries

L-P: guidance for European Council needed, saying that there are no easy options and that experience to date (at national + Community level) does not offer assurance that such policies would be effective implications of other Community policies would have to be taken into account.

[The creation of a single market and the locking of exchange rates would take place in a situation in which, owing to ill-adapted structures and differences in productivity, some major regional disparities would still exist.] The impact of economic and monetary integration on these disparities may be difficult to assess: on the one hand, economic integration would provide less developed regions with lower wage levels with an opportunity to attract modern and rapidly growing service and manufacturing industries for which the choice of location would not necessarily be determined by transport costs and market proximity. On the other hand, however, transport costs and economies of scale would tend to favour a shift in economic activity away from less developed regions, especially at the periphery of the Community, to the highly developed areas ~~in~~ its centre. ~~The~~ economic and monetary union ~~should~~ avoid undue economic and political tensions arising from possible dislocations of industries and labour forces. ~~Therefore, it~~ would have to encourage and guide structural adjustment which would help the Community's poorer regions to catch up with the wealthier ones. To this end, the Community would have to develop further an effective policy and be endowed with adequate financial resources to allow it to support regional development efforts undertaken at national levels.

A step in this direction was taken in February 1988 when the European Council decided to strengthen and reorganise the Community's regional policies in two respects: the size of structural funds will be doubled over the period up to 1993, emphasis will be shifted from project to programme financing, and a new form of partnership was established between the Community and the receiving regions. In the process of creating economic and monetary union such policies ~~would~~ have to be strengthened further after 1993, depending on the speed of progress towards ec. + mon. union.

] The principal objective of regional policies should not be to subsidise incomes and simply temper inequalities in standards of living, but to help to equalise production conditions through investment programmes in such areas as physical infrastructure, communication, transportation and education so that large-scale movements of labour do not become the major adjustment factor. The success of these policies will hinge not only on the size of the available financial resources, but to a decisive extent also on

L-P. 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.

[if they were

x at] if it were to be undertaken before the disparities were reduced, to (L-P)

— the Community

L-P: could also make clear the continuing role that national and regional policies will play, even within ec. + monetary union not everything will be done by the Centre

√ might

] At the same time excessive reliance on financial assistance through regional and structural policies could cause tensions that need to be avoided. (Pöhl)

L-P: could be another

their efficient use and on the private and social return of the investment programmes. Indeed, the more recent experience of countries inside and outside the Community has shown that structural and regional development programmes have been particularly successful when improvements in the resource base of regions encouraged by investment in infrastructure and education have been reinforced by decentralised initiatives for local entrepreneurship, modernisation of urban areas and local institutional arrangements favouring development. A long-term approach would offer countries with lower levels of productivity an appropriate period of transition and in this sense would constitute an essential element of the policy mix to ensure continuing economic integration.

In certain areas such as infrastructure, research and technological development, and environment, the Treaty of Rome as amended by the Single European Act have laid the foundations of Community policies aimed at common goals. Such policies would not only enhance market efficiency and offset market imperfections, but could also contribute to regional development. Subject to the limits of the principle of subsidiarity, such policies would have to be developed in the process towards economic and monetary union.

L-P: could be omitted

[Sufficient wage flexibility and labour mobility should contribute to avoiding changes in competitiveness in different regions and countries of the Community that could lead to] relatively large declines in output and employment in areas with deteriorating competitiveness. In order to reduce adjustment burdens temporarily, it might be necessary in certain circumstances to organise financing flows through official channels. Such financial support would be additional to what might be provided by spontaneous capital flows or external borrowing and should be granted on terms and conditions that would prompt the recipient to intensify its adjustment efforts.

L-P: If wage flexibility and labour mobility are insufficient to eliminate differences in competitiveness in different regions and countries of the Community there could be

[ ]

33. <u>Macro-economic policy</u> is the third area in which action would be necessary ~~in order to have~~ a viable economic and monetary union and to draw from it maximum benefits. This would require an appropriate definition of the role of the Community in the co-ordination of economic policies.

for L-P: Omit

The major developments affecting macro-economic conditions would continue to be determined by factors and decisions operating at the national level. This would apply not only to wage negotiations and other economic behaviour in the fields of production, savings and investment, but also to the action of public authorities in the economic and social sphere. Aside from the system of binding rules governing the size and the financing of national budget deficits, decisions on the main components of public policy in such areas as internal and external security, justice, social security, education, and hence on the level and composition of government spending as well as many revenue measures would remain the preserve of member states even at the final stage of economic and monetary union. Only if the provision of major public goods constituting the bulk of public sector activity were attributed to a large extent to the Community level would the Community budget be significantly enlarged.

However, an economic and monetary union could only operate on the basis of mutually consistent and sound behaviour by governments, unions and other economic agents in all member countries. In particular, unco-ordinated and divergent national budgetary policies would not only undermine monetary stability, but would also generate imbalances in the real and financial sectors of the Community and render it impossible to pursue appropriate macro-economic policies for the Community as a whole. Similarly, strong divergences in wage levels not justified by different trends in productivity would produce economic tensions and pressures for monetary expansion.

To some extent market forces would exert a disciplinary influence because financial markets, consumers and investors would respond to differences in macro-economic developments in individual countries and regions, assess the budgetary and financial position of different countries, penalise deviations from commonly agreed fiscal guidelines or wage settlements, and thus exert pressure for sounder policies. However, experience suggests that market perceptions do not necessarily provide strong and compelling signals and that access to a large capital market may for some time even facilitate the financing of economic imbalances. Rather than leading to a gradual adaptation of borrowing costs, market views about the creditworthiness of official borrowers tend to change abruptly and result in the closure of access to market financing. The constraints imposed by market forces might either be too slow and weak or too sudden and disruptive. This is why countries will have to accept that sharing a common market and a single currency area imposes policy constraints.

L-P: omit whole page

In the budgetary field binding rules are required that would, firstly, impose effective upper limits on budget deficits of individual member countries of the Community; secondly, exclude access to direct central bank credit and limit recourse to external borrowing, including borrowing in non-Community currencies. With a view to effective control and coordination of market borrowing by public entities at all levels, a "public finance coordinating authority" consisting of representatives of all such entities should be established. One of its objectives would be to facilitate the conduct of a coherent mix of fiscal and monetary policies. (Pöhl)

last para on p24

In the general macro-economic field, an overall assessment of the short-term and medium-term economic developments of the Community should be agreed periodically and constitute the framework for a better co-ordination of national economic policies. The Community should be in the position to monitor its overall economic situation, to assess the consistency of developments in individual countries with regard to common objectives and to formulate guidelines for policy.

concept of social partners

L-P: not unanimously accepted; wishes to omit para

As regards wage formation and industrial relations, the autonomous negotiating process of social partners should be preserved and strengthened with a view to improving the prospects for growth and employment. To this end efforts would have to be made to convince European management and labour of the advantages of gearing wage policies largely to improvements in productivity. Governments, for their part, should strengthen tendencies towards reducing or completely eliminating direct intervention in the wage and price formation process.

L-P: imbalances

Pöhl redraft (see previous page)

In the budgetary field, particular arrangements would be necessary. Such arrangements should, firstly, impose effective and binding limits on budget deficits that could be incurred by individual member countries of the Community, although in setting these limits the situation of each member country might have to be taken into consideration. Secondly, the arrangements would have to include (in accordance with the criteria laid down for a European System of Central Banks) strict limits - both in size and duration - on the maximum permissible access to central bank credit, as well as on borrowing in non-Community currencies. Thirdly, the arrangements should enable the Community to conduct a coherent mix of fiscal and monetary policies, i.e. to dispose of a system of rules that could be applied with a view to determining the aggregate balance on national budgetary positions, including that of the Community.

L-P: monetary

34. In summary, the establishment of an economic union would require:

- the creation of an internal market without physical, technical or fiscal frontiers, supplemented by a competition policy which effectively removes distortions in competition;
- a system of policies to stimulate regional and structural developments through multi-annual investment programmes, which

would help regions with lower productivity to catch up with the more developed parts of the Community;

- common policies with regard to infrastructure, research and technological development, and environment, which would help to exploit the full potential of the single market and complement its role in the allocation of resources;
- consideration of the social dimension of the European Community;
- a framework for monitoring and co-ordinating general short-term and medium-term economic developments in the Community with a view to attaining non-inflationary, balanced economic growth;
- effective and binding ~~co-ordination procedures~~, which would ~~enable the Community to determine its~~ macro-fiscal policy stance, t~~o set maximum possible deficits for national budgets taking in~~to ~~consideration the situation of each member country, and limits on both monetary financing~~ and borrowing ~~in third currencies~~.

(-P: omit these indents

(-P: need is rather to decide on zones for budget imbalances, which should take account of the differing needs of each of the member countries

+ rules to ensure a coherent [stance] in the Community, exclude access to direct central bank credit and limit recourse to borrowing in third currencies.

4. Institutional arrangements

35. Management of the economic and monetary union would ~~therefore~~ call for an institutional framework which would allow policy to be decided and executed at the Community level in those economic areas that were of direct relevance for the functioning of the union. The institutional framework would have to guarantee efficient economic management, properly embedded in the democratic process. The creation of a monetary union would necessitate the setting-up of a new monetary institution, placed in the constellation of Community institutions (European Council, Council of Ministers, European Parliament, Commission and Court of Justice). Although the establishment of economic union would not necessarily require the creation of a new institution, the formulation and implementation of common policies in non-monetary fields and the co-ordination of policies under the competence of national authorities could require a revision and, possibly, some restructuring of existing Community institutions.

(-P

36. The need for a new monetary institution arises because a single monetary policy cannot be decided and implemented independently by different central banks and because day-to-day monetary policy operations can respond quickly to changing market conditions only if they are decided

(-P: a single monetary policy can be decided and implemented independently, though it is arguable that it might be more desirable for it to be decided centrally.

centrally. For these reasons the Community's domestic and international monetary policy would have to be organised in a European System of Central Banks (ESCB). The System would have to be given the status of a new and autonomous institution of the Community, operating under the provisions of the Treaty and could consist of a central institution (with its own balance sheet), and national central banks. At the final stage the ESCB - acting through its Council - would fo~~rmulate and decide the targets of~~ monetary policy ~~and manage~~ the Community's exchange rate vis-à-vis third currencies. The national central banks would be entrusted with the implementation of policies in conformity with guidelines established by the Council of the ESCB and in accordance with instructions from the central institution.

[-?: could be organised according to some federal form that might be called a

[be responsible for formulating and implementing
as well as managing

The European System of Central Banks, which would embody the Community's monetary order, should rest on the following basic principles:

Mandate and functions

- the System would be responsible for the formulation of monetary policy at the Community level, for the co-ordination of policy implementation at the national level, for the full convertibility of European currencies, and for the maintenance of a properly functioning payment system; the System would ~~be committed~~ to regulate the amount of money in circulation and the volume of credit supplied by banks and other financial institutions ~~on the basis of criteria designed to ensure~~ price stability ~~as well as economic growth~~;
- the System would ~~be responsible for the formulation of banking supervisory policy at the Community level and for~~ co-ordination of banking supervision policies of the national supervisory authorities.

] and its implementation at the national level

have [-P: the System would be committed to promoting price stability as well as economic growth
with a view to safeguarding overall

participate in the

Status

- independence of instructions from national governments and Community authorities;
- proper democratic legitimisation through reporting and appointment procedures;

- appointment of the members of the Board by the European Council on the proposal of the ESCB Council; the tenure of Board members would be for five to seven years and would be irrevocable;
- transmission of an annual report by the ESCB to the European Council and the European Parliament; the Chairman of the Board could be invited to report to these institutions;
- supervision of the administration of the System independently of the Community bodies, for example by a supervisory council or a committee of independent auditors.

L-P: suggest omission; if at all necessary, better in Part III

Structure and organisation

- a federative structure, since this would correspond best to the political structure of the Community;
- establishment of a European Central Bank Council (composed of the Governors of the central banks and the members of the Board), which would be responsible for the formulation of and decision on the thrust of monetary policy;
- establishment of a Board (with supporting staff), which would monitor monetary developments and oversee the implementation of the common monetary policy;
- national central banks, which would execute operations in accordance with instructions given by the Board.

Policy instruments

- the instruments available to the System, together with a procedure for amending them, would be specified in its statutes; the instruments would comprise both regulatory powers and the authority to conduct central banking operations in money and foreign exchange markets;
- there would be strict limitations on lending to all public authorities;
- the monetary policy instruments would be oriented towards a free market economy.

L-P: unnecessary to specify in the statutes the instruments available
not clear why ESCB should need the authority to conduct . . . . .

37. In contrast to the monetary field, in the economic field an institutional framework for performing policy tasks is already in place,

with different and complementary functions conferred to the Council, the European Parliament, the Commission and the Court of Justice. The new Treaty would therefore not have to determine the mandate, status and structure of a new institution but to complement and adapt the role of the existing institutions in the light of the policy functions they would have to fulfil in an economic and monetary union. The new Treaty would have to specify this adaptation ~~in accordance with certain general criteria and with reference to the four main policy areas described above~~.

and determine the areas where additional decision-making authority would have to be transferred from the national to the Community level.

General criteria

In order to ensure a flexible and effective conduct of policies in those economic areas in which the Community would be involved, three basic requirements would have to be fulfilled:

- to the extent that policies were decided and enacted at the Community level, there would have to be a clear distribution of responsibilities among the existing Community institutions, with due regard to whether decisions relate to the setting of broad policy directions or to day-to-day operations in the light of current developments. By analogy with the structure of the European System of Central Banks, where the ESCB Council would determine the broad lines of monetary policy and the day-to-day execution of these policies would be in the hands of the Board, a similar allocation of responsibilities ~~between~~ could be envisaged in the economic field by assigning the right to determine the broad lines of economic policy to the Council of Ministers ~~and the Commission could be envisaged in the economic field;~~ while the day-to-day execution of these policies would be in the hands of the Commission
- in those areas in which the Community's role would be to co-ordinate policies that are decided and implemented by member countries, compliance with the Community's policy framework would have to rely on a system of binding rules to individual member states including the possibility - for the Council or the Commission - to sanction departures from the agreed policy line;
- discretionary changes in Community resources, in the level of harmonised taxation rates and in the terms and conditions attached to structural policies and Community loans should become available instruments and incentives in support of agreed policies;

L-P: there is no commitment to harmonised tax rates and not clear what institution ~~should~~ is supposed to be recommending...

- in case of non-compliance by a member state the Commission would have the responsibility for taking effective action to assure compliance; the nature of such action would have to be explored.

Also Duisenberg

Single market and competition policy

In these two areas, the necessary procedures and arrangements have already been established by the Treaty of Rome and the Single European Act, conferring upon the Community the legislative, executive and judicial authority. While for economic agents the completion of the internal market represents a marked easing of the overall burden of regulation, for the Community institution the 300 new directives necessary to create and maintain the single market will represent a substantial addition to their executive and policing functions. [New instruments and procedures to enforce the rules of the single market might prove necessary after 1992.]

L-P: These mechanisms might have to be further extended and made more effective, depending upon the speed of progress towards ec. + mon. union.

Community policies in the regional and structural field

The foundations for a more effective Community role in regional and structural development have recently been put in place, involving both a doubling of the resources of structural funds and a reorganisation of policies as described in earlier parts of this report. At a more advanced stage of the process these mechanisms would have to be further extended and made more effective.

Macro-economic policy

The broad objective of co-ordination ~~of general economic policies~~ would be to promote growth, ~~and~~ employment in an environment of price stability ~~and economic cohesion~~. For this purpose co-ordination would involve: defining a medium ~~and short-term policy approaches, bearing in mind their economic and social implications~~; ~~participating in the policy co-ordination with the other areas of the industrial world; setting a multi-year framework for national and Community budgetary policies;~~ managing common policies~~, particularly~~ with a view to ~~improving~~ structural and regional development; ~~and~~ determining, in close consultation with the ESCB Council, the Community's exchange rate policy; and participation in policy coordination at the international level required for this purpose

~~This is the field where~~ New procedures ~~would have to be developed. Firstly, they~~ would have to strike a balance between ~~co-ordination through~~ binding rules and discretionary co-ordination adapted to a particular economic situation. ~~Secondly, they would have to cover both horizontal co-ordination - between member countries and the Commission and the Council - and vertical co-ordination between a member country and the Commission.~~

economic policy

and external balance

L-P: excessive emphasis is given to role of the Commission, and of all proportion to its small budget.

-term framework for budgetary policy within the economic and monetary union;

reliance on

where necessary to ensure effective implementation

~~In this context~~ it would ~~be~~ necessary to develop ~~an effective~~ procedures for ~~joint decision-making in the field of~~ budgetary policy. ~~This would~~ involving:

- the definition of the overall stance of fiscal policy, ~~i.e.~~ the size and the financing of the aggregate budgetary position in the Community;
- binding rules and collective decisions concerning budget deficits which could be incurred by individual countries;
- strict limits on the maximum permissible access to monetary financing as well as on borrowing in non-Community currencies.

In particular.

T over the medium-term, including

- strict limitations on public borrowing, e.g. related to public investment requirements;
- exclusion of access to central bank credit and other monetary financing;
- strict limitations of borrowing in non-Community currencies.

38. The new Treaty laying down the ~~programme~~, procedures and organs of the economic and monetary union would ~~create a situation in which the~~ existing Community institutions (European Council, Council of Ministers, European Parliament, Commission and Court of Justice) would be supplemented by a new institution of comparable status, the European System of Central Banks. Relationships and interactions between these bodies would have to be defined not only in order to construct a consistent institutional framework, but also to ensure an effective procedure of consultation and co-ordination between budgetary and monetary policies. To this end appropriate relations would have to be established on a regular basis between the existing institutions and the European System of Central Banks, providing for consistent consultation procedures without, however, impinging on the policy responsibilities entrusted to each institution in its own field of economic and monetary management. Such consultation procedures could include participation by the President of the Council and the President of the Commission in meetings of the ESCB Council, ~~and participation~~ by the Chairman of the ESCB Council in meetings of the Council of Ministers. ~~An involvement of the European Parliament and~~ national parliaments in the co-ordination process could be considered in addition to the role to be played by the Council and the Commission, and the European Parliament could be consulted ~~in~~ advance on the stance of economic policy in the Community. The consultation process should include a yearly joint assessment of the overall economic and monetary situation and prospects, ~~and~~ the formulation of a general policy guideline for the year to come. Moreover, the Council of Ministers and the Commission would submit

objectives, features, requirements

add to

[ ] With due respect for the independent status of the ESCB, as defined elsewhere in this Report, appropriate consultation procedures would have to be set up to allow for effective coordination between budgetary and monetary policy. To this end, attendance by

Ciampi: not wise to go into detail, foreseen this "cross" participation

T without power to vote or to block decisions taken in accordance with the rules laid down by the ESCB Council, should be provided for. Equally, attendance

T should be provided for, especially on matters relating to budgetary and other policies of relevance to the conduct of monetary policy. Consideration should be given to the role of the European Parliament especially in relation to the authority evolving on the Commission in budgetary matters, where the latter should be accountable to the European Parliament. The same should apply in regard to action, or non-action, taken by the Commission in budgetary field.

Case of non-compliance by member countries: action to be taken at the Community level and hand member countries' governments, responsibility can only be to European parliament.

Duisenberg! Any policy decisions at the Community level binding member countries in the field of their public finance constitute actions for which in democracies responsibility vis-a-vis parliament is clearly required. This also applies to any action or lack of action on the part of the Commission in the response to non-compliance of a member country with binding rules or decisions especially in the a report each ~~year to the~~ European Council and the European Parliament on the functioning and the status of the ~~economic and~~ monetary union.

5. Economic and monetary union in the context of the world economy

(– P: omit this section

39. The realisation of an economic and monetary union in Europe would significantly increase the weight of the Community in the world economy and strengthen its opportunity of playing a multilateral role. The creation of a market without internal barriers, a single currency area and an effective system for policy formulation and implementation would not only be crucial for achieving a high degree of economic stability and satisfactory growth within the Community; it would, at the same time, enable the Community to fulfil its growing responsibilities in an increasingly integrating world economy in which developments inside and outside Europe will interact, and mutual benefits will depend on growing co-operation and concertation of policies. Economic and monetary union would give a more important voice to the Community in international negotiations and enhance its capacity to influence the relations among industrial and developing countries in a wide range of areas such as trade policies, international monetary matters, macro-economic policy concertation and the North-South dialogue.

40. The competence for external trade policy has been attributed to the Community in the Treaty of Rome and the Commission, acting as the Community's spokesman, represents all member countries in multilateral trade negotiations. This role will undoubtedly be strengthened with the completion of the single market which presents an immense potential in terms of purchasing power and as a vehicle for stimulating multilateral trade and economic growth at the global level. However, this potential can only be exploited to its full extent in an open trading system, guaranteeing foreign suppliers free access to the Community market and, conversely, exporters from the Community free access to foreign markets. The removal of internal trade barriers within the Community should constitute a step towards a more liberal trading system on a worldwide scale.

41. The creation of a single currency area and, concomitantly, the move to a single monetary policy conducted by the European System of

Central Banks will strongly increase the role of the Community in international monetary matters. The liberalisation of capital movements and the integration of financial sectors under the internal market programme will generate a vast financial space and the potential of this market would be greatly enhanced by the introduction of a single currency, which would be likely to develop into an attractive investment instrument for foreign private residents and official authorities alike. The Community would have to assume a growing responsibility for international monetary developments, both with regard to more short-term co-operation at the level of central banks in interest rate management and exchange market interventions as well as in the search for solutions to issues relating to the further development of the international monetary system.

42. As economic and monetary union necessitates an effective macro-economic management for the Community as a whole, it would also strengthen the Community's position in the process of international policy concertation among major industrial countries. However, for the Community to play its part in this respect, the arrangements for internal macro-economic policy formulation and implementation would have to be sufficiently flexible, allowing the Community not only to respond effectively to changing economic circumstances in its internal economic situation, but also to be able to co-ordinate policies in a manner satisfactory to both the Community and other major industrial countries.

43. The institutional arrangements which would enable the Community to fulfil the responsibilities implied by its increased weight in the world economy and to influence international economic developments are partly in place or would be implemented in the process of creating an economic and monetary union. In the area of external trade policies and, to some extent in the field of co-operation with developing countries, the necessary functions have been attributed to the Community. With the establishment of the European System of Central Banks the Community would also have created an institution through which it could participate in all aspects of international monetary management. As far as macro-economic policy co-ordination at the international level is concerned, the Community as such is currently represented only at the summit meetings of the major industrial countries. In order to make full use of its position in the

world economy and to exert influence on the functioning of the international economic system, the Community would have to be able to speak with one voice. This emphasises the need for an effective mechanism for macro-economic policy co-ordination within the economic and monetary union.

III. <u>Steps towards economic and monetary union</u>

1. <u>Principles governing a step-by-step approach</u>

44. The request made by the European Council to the Committee to study "concrete stages" reflects the awareness that an economic and monetary union, as outlined in Part II of this Report, is too profound a change in the economic and institutional structure of the Community to be realised at one stroke. Households, firms, unions, public authorities and governments themselves would need time to adapt ~~their economic behaviour~~ to a new setting. Similarly, it would not be possible to change the balance of power within the Community at once in all fields. Rather, it would be necessary to build on success and to retain the possibility of correcting the course of action in the light of new experiences.

The ambition of the final objective, the present diversity in the situations of the European countries and the variety of areas involved - which go well beyond the economic and monetary sphere - make it necessary to be clear concerning the path to be mapped out.

In <u>designing a step-by-step approach</u> along this path the general principle of subsidiarity, referred to earlier in this Report, as well as a number of further considerations, would have to be taken into account.

45. <u>Discrete but evolutionary steps</u>. The process of implementing economic and monetary union would have to be divided into a limited number of clearly defined stages. Each stage would have to represent a significant change with respect to the preceding one. New arrangements coming into force at the beginning of each stage would gradually develop their effects and bring about a change in economic reality so as to pave the way for the next stage. This evolutionary development would apply to both functional and institutional arrangements.

- Reinbrechen
working committee

- Com proposal for
stage 4

Thygesen text

world economy and to exert influence on the functioning of the international economic system, the Community would have to be able to speak with one voice. This emphasises the need for an effective mechanism for macro-economic policy co-ordination within the economic and monetary union.

Ciampi:
in stage I ~~the~~ strengthening

III. Steps towards economic and monetary union

1. Principles governing a step-by-step approach

44. The request made by the European Council to the Committee to study "concrete stages" reflects the awareness that an economic and monetary union, as outlined in Part II of this Report, is too profound a change in the economic and institutional structure of the Community to be realised at one stroke. Households, firms, unions, public authorities and governments themselves would need time to adapt [their economic behaviour] to a new setting. Similarly, it would not be possible to change the balance of power within the Community at once in all fields. Rather, it would be necessary to build on success and to retain the possibility of correcting the course of action in the light of new experiences.

Pöhl: delete
de Lar.: "

Pöhl: [and its limiting

The ambition of the final objective, the present diversity in the situations of the European countries and the variety of areas involved - which go well beyond the economic and monetary sphere - make it necessary to ~~be clear concerning the path to be mapped out~~.

L-P: to establish clearly the principles, but also make the mapping of a precise course impossible.

In designing a step-by-step approach along this path the general principle of subsidiarity, referred to earlier in this Report, as well as a number of further considerations, would have to be taken into account.

45. Discrete but evolutionary steps. The process of implementing economic and monetary union would have to be divided into a limited number of clearly defined stages. Each stage would have to represent a significant change with respect to the preceding one. New arrangements coming into force at the beginning of each stage would gradually develop their effects and bring about a change in economic reality so as to pave the way for the next stage. This evolutionary development would apply to both functional and institutional arrangements.

L-P: suggests redraft
de Lar.: keep text

46. Parallelism. Parallel advancement in economic and monetary integration would be indispensable to avoid imbalances which could cause economic strains and loss of political support for further developing the Community into an economic and monetary union. However, perfect parallelism at each and every point of time would be impossible and could even be counterproductive. Already in the past the advancement of the Community in certain areas has gone hand in hand with temporary standstill in others, thus involving only partial parallelism. A certain amount of temporary deviations from parallelism is part of the dynamic process of the Community. However, parallelism would have to be maintained in the medium term.

47. Calendar. The conditions for moving from stage to stage cannot be defined exactly in advance. They would depend on too many factors to permit the setting of explicit deadlines. The timing of, especially, the move to irrevocably fixed exchange rates would have to be judged in the light of circumstances by the Council, the Commission and the European System of Central Banks (ESCB), which would have been created in the second stage. A firm commitment to the final stage, as described in Part II of this Report, would, however, be indispensable. There should be a clear indication of the timing of the first step. It could coincide with the decision to draw up a new Treaty, thus anticipating the entry into force of the Directive for the full liberalisation of capital movements on 1st July 1990. It might be envisaged that this first stage would be completed with the implementation of the single market at the end of 1992.

48. Indivisibility and gradualism. Gradual progress in a step-by-step approach should not at any point in time produce ambiguities about the ultimate responsibility for each policy decision and its execution. Unless it is unmistakable who (i.e. whether national governments or the Community; which organ or institution) has "the last word", there would be a risk of market uncertainty and policy conflict. Policy responsibilities are not equally divisible in all areas.

In the monetary field, once exchange rates were irrevocably locked - as was pointed out in Part II of the Report - a common monetary policy would be required and would have to be formulated collectively in the framework of the European System of Central Banks. As the authority

L-P: As has been argued in Part II, monetary union without a sufficient degree of convergence of budgetary policies is unlikely to be durable and could be damaging to the Community

de Lar agrees

Pöhl ~~In essence~~, parallelism would have to be maintained in the medium term but also before proceeding from one stage to the next.

de Lar agrees

L-P: withdraw of second part para

Pöhl: redraft

Hoffmeyer → amendment to Lamfalussy proposal

Duisenberg: delete

de Lar agrees but wants to add "immediately" after to enter in second last line

de Lar: omit

end, at the end,: The beginning of the first stage will coincide with such a decision to start the negotiations of a new Treaty, thus anticipating the entry into force of the Directive for the full liberalisation of capital movements on 1st July 1990."

Pöhl: decided

over monetary policy cannot be shared out among several autonomous decision-making bodies, the ultimate decision-making power over each Community currency would rest with the respective national monetary authorities until exchange rates were locked. [This sets the limit of the possible attribution of policy functions to the central institution before the final stage.]

At the same time, however, if the objective of economic cohesion and the attainment of progressive exchange rate stability were not to be put in jeopardy, the extent to which the national decision-making power could be exercised in practice would be increasingly constrained for all central banks and decisions would perforce have to taken increasingly within a framework of close co-operation and co-ordination. As suggested in the description of concrete steps, collaboration [and common decision-making] with regard to certain operations could be greatly strengthened long before the responsibility for monetary policy was actually transferred to the ESCB.

Pöhl: delete

[In the economic field policy responsibilities can be, and are, shared between different levels of government in all constitutional systems. This facilitates a step-by-step approach to economic and monetary union.]

L-P: omit, or redraft

Pöhl: add: However, already in the first stage a significant strengthening of coordination procedures in the economic field must be established with recommendations formulated collectively and regular evaluation of progress in major economic areas.

49. Participation. There is one Community, but not all the members have participated fully in all its aspects from the beginning. So far this has mainly been the consequence of successive enlargements and, for the EMS, of the [decision of some countries not] to join the exchange rate mechanism ~~agreement~~. [A consensus on the final objectives of the Community, as well as participation in the same set of institutions, should be maintained, while allowing for a degree of flexibility concerning the date on which some member countries would join certain arrangements.] The management of each set of arrangements [should be] the responsibility of those who participate fully in it.]

L-P: redraft

de Larosière: [of the fact that some countries have not yet taken the decision

maintain this sentence

[Pending the full participation – which is of prime importance –

[ ] would have to be

this section → add: However, this management would have to keep in view the need to facilitate the integration of the other members.

L-P: replace [by his own draft and place at end of Part III

2. The Treaty

50. The implementation of economic and monetary union would, in accordance with Article 102A as introduced into the Treaty of Rome by the Single European Act, have to be embodied in a new Treaty. This Treaty would

Andriessen: redraft!

de Larosière: agrees with editing of 50-52, but understands that they are incorporated in Duisenberg text on follow-up provide the legal foundation on which the institutional framework of, and concomitantly the distribution of policy responsibilities in, an economic and monetary union, as described in Part II of the Report, would be based.

The Committee has examined the scope for progress in economic and monetary integration under the present legal provisions in force in each member country. This investigation has shown that unless national legislations are amended in various respects, the scope for further action on the part of national authorities will be narrow: no member country is able to transfer decision-making power to a Community body, nor is it possible for some countries to participate in arrangements for a binding ex ante co-ordination of policies. [As a consequence, concrete steps towards economic and monetary union would have to be confined to measures strengthening co-operation, mutual surveillance, analysis of developments and non-binding co-ordination of policies until a new Treaty had been ratified. More substantive steps would require the conclusion of a Treaty.]

Pöhl: redraft : to become a separate para

51. [One] procedure would be to conclude a new Treaty for each stage. The advantage of this procedure would be that it would explicitly reaffirm the political consensus at each stage[. Its disadvantage would be that, as well as being unwieldy and slow, the overall consistency of the process might not be sufficiently safeguarded and sight might be lost of the ultimate objective. It would also carry the risk that progress in parallel between the monetary and non-monetary sides would not be respected.

Pöhl: Another

L-P [and would allow for modification of the form the following stage should take in the light of experience with the current stage

52. Alternatively, it could be decided to conclude a single comprehensive Treaty [which would clearly formulate] the essential features and institutional arrangements of economic and monetary union and the steps in which it could be achieved. [[Such a Treaty could facilitate the implementation process through the provision of "organic laws" and enabling clauses and it could also indicate the procedures by which the decision would be taken to move from stage to stage.] Each move would require an appraisal of the situation and a decision by the European Council.]

L-P: [ ] formulating.

L-P: [Each move would require an appraisal of the existing situation and a decision by the European Council. Such a Treaty simplifying the political process of implementation through the provision of "organic laws" and enabling clauses, indicating also the procedures by which the decision would be taken to move from stage to stage.

Pöhl [ ] Such a Treaty would indicate the procedures by which....

3. The ecu

53. The Committee examined various aspects of the role that the ecu [could be expected] [to] play in the process of economic and monetary

L-P [~~?~~ might]

integration in Europe. [The Committee is of the view that the ecu [should develop into] the future single currency of the Community. [The realisation of this objective would take time and it should not be forced by] issuing ecus before the final stage as an independent currency in addition to the existing national currencies. On the other hand, it would require that the ecu, remaining a basket of currencies, should become as stable as the currencies participating fully in the exchange rate arrangements. In order to be able to develop into the future single currency, it would be essential that market participants become better acquainted with the ecu and that, as a result of a market-determined process, the use of the ecu in financial and commercial transactions would spread throughout the Community. As far as the official ecu was concerned, the Committee felt that, apart from increasing the operations in official ecus within the EMS and enlarging the group of third holders, the official ecu could possibly be employed as an instrument of monetary policy co-ordination at an advanced stage of integration. As far as the private ecu was concerned, a number of promotional measures could be envisaged which would encourage its use in private markets.]

The Committee's conclusions and proposals regarding this important subject are to be found in several parts of the Report. They concern both the final phase and the intermediate stages of the economic and monetary union. For expositional convenience the conclusions are summarised here in four propositions.

L-P: prefers to replace the whole section by his draft, paras 12 + 13
or at least
[ ] whatever the form it eventually takes, could become
[ ] This would require the support of the markets and their customers and this process would take time and could not be forced by...

Pöhl: [ ] delete, and connect with second sub-para
de Lar.: agrees

54. Firstly, the Committee was of the opinion that the ecu should develop into the future currency of the Community. Although a monetary union does not necessarily imply a single currency, political and psychological reasons suggest that a single currency would be a natural and desirable feature of a monetary union. A declaration that the ecu should develop into the future currency of the Community is desirable. It would assure private agents that there would be no discontinuity between the present ecu and the single currency of the union and that ecu obligations would be payable at face value in ecu if the transition to the single currency had been made at the time of the maturity of the contract.

Pöhl: redraft

55. Secondly, the Committee considered the possibility of adopting a parallel currency strategy as a way to accelerate the pace of the monetary

union process. According to this approach the definition of the ecu as a basket of currencies would be abandoned at an early stage and the new fully-fledged currency, called ecu, would be created autonomously and issued in addition to the existing Community currencies. The new ecu would be a parallel currency in the sense that it circulated alongside national currencies and competed with them. The proponents of this strategy expect that the gradual crowding-out of national currencies by the ecu would make it possible to circumvent the institutional and economic difficulties of establishing a monetary union. The Committee felt that this strategy is not to be recommended for two main reasons. Firstly, an additional source of money creation without a precise linkage to economic activity could jeopardise price stability. Secondly, the addition of a new currency, subject to an independent monetary policy, would further complicate the already difficult endeavour of co-ordinating different national monetary policies.

56. Thirdly, the Committee examined ways for increasing the use of the official ecu. One possibility in this direction was to employ the official ecu as an instrument in the conduct of a common monetary policy. Under such a scheme the official ecu would serve as a reserve instrument, establishing a link between each national central bank and the central institution of the European System of Central Banks. Before the final stage, the official ecu would circulate only among central banks and provide a basis for an operational framework for a common monetary policy that would replace voluntary co-ordination. [The Committee felt that such a proposal was one possible way of preparing the ground for a common monetary policy in the course of the second stage.]

57. Fourthly, the Committee agreed that a number of measures could promote the voluntary use of the ecu by the private sector as a unit of account and as a means of settlement. In order to avoid undesirable distortions in the financial markets there should be no official discrimination in favour of the ecu; there should, however, be both direct and indirect encouragement. Direct encouragement should aim at increasing the critical mass of transactions in ecu, for example, by stepping up borrowing in ecus by public authorities, increasing the use of the ecu in official transactions inside and, whenever possible, outside the Community,

Tie: delete

Delors: replace second sentence by: "If, at a later stage, required reserves are maintained with the European System of Central Banks, these reserves would be denominated in ecus"

[ ]

L-P: Add at the end: A number of members of the Committee felt that such proposal might be one possible way of preparing the ground for a common monetary policy in the course of the second stage. Other members of the Committee felt this was neither adequate nor appropriate as a solution to the problem of ensuring equivalent monetary policies in the chosen monetary framework of the 12 member states.

Pöhl: reference to artificial support should be deleted utilising the ecu more extensively in exchange market interventions, [and providing greater support to the ecu clearing system.] One of the most important measures to promote indirectly the use of the ecu would be the declaration that the ecu should develop into the future single currency of the Community. This should provide a clear signal to the private sector to familiarise itself with the ecu. An additional indirect incentive would be the removal of all administrative restrictions on the use of the ecu as a means of settlement and for accounting purposes. In particular, after having been granted the status of a foreign currency, consideration could be given to putting the ecu on an equal footing with the national currency in each member country. Moreover, evidence of a greater use of the official ecu within the EMS and a growing number of official institutions outside the Community holding such ecus could be another form of indirect encouragement.

L-P: delete

4. Concrete steps in three stages

58. The Committee is of the view that the evolution towards economic and monetary union could be divided into three major stages. In each stage a number of concrete and parallel steps would be implemented in the ~~institutional~~, economic and monetary field which would advance the process of integration, ensure the gradual construction of the ~~institutional~~ framework and reorganise policy responsibilities in accordance with the requirements of an economic and monetary union.

de Lar: omit 58-61 and incorporate essence in other parts of the report

Pöhl: delete

59.[Both strategic considerations and actual economic developments would call for a particularly careful design of the first stage. Firstly, in order to impart a strong momentum to the process of economic and monetary union, and to underpin its credibility, there would have to be a clear and convincing political endorsement of the final objective reflecting the common will of Community countries. Secondly, it would have to be taken into account that the implementation of the internal market programme currently under way will significantly affect the economic environment in the Community. In particular:

Pöhl: redraft

- the complete liberalisation of capital transactions by the middle of 1990 is an irreversible process in which the European countries are already engaged. This will impose considerable, though differing, constraints on national policies and therefore necessitate a substantial reinforcement of monetary and economic policy co-ordination.

- in the monetary field the central banks will have to co-ordinate their policies much more closely at both internal and external levels;

C-P are likely to have

- on the external side, the sizable fluctuations within the international monetary system have led central banks to rely more heavily on intervention in the foreign exchange markets on a co-ordinated basis. However, such a policy inevitably has a direct influence on the implementation of domestic monetary policies in these countries. It is therefore necessary and urgent that central banks create means for analysing such issues on a permanent and common basis. It is not only a matter of strengthening the impact of their operations, but also of maintaining the efficiency of their monetary management both at domestic and European levels;
- on the internal side, the tendency of the European central banks to conduct their monetary policies within the framework of the EMS in the light of domestic considerations in their respective countries is not necessarily conducive to fostering a monetary policy satisfactory for the Community as a whole. The creation of a common monetary think-tank for analysis and recommendations would make it possible to address this problem better. The deliberations within this monetary think-tank would in effect provide all central banks with a better basis for setting their own national approaches in a European context while preserving full decision-making autonomy;
- in the economic field the co-ordination of policies conducted at national levels as well as at the Community level will have to be strengthened considerably in recognition of the constraints generated by the growing economic integration under the internal market programme. The procedures for policy co-ordination laid down in the 1974 Convergence Decision will therefore have to be revised and made more effective in order to ensure that

C-P would need

macro-economic policies, especially in the budgetary area, are coherent and consistent with exchange rate commitments.]

The desirability of a clear demonstration of a common political will and the challenges of market integration would call for substantial and effective measures at the beginning of stage one, although, as noted earlier, the scope for such measures would be limited as long as a new Treaty had not yet been ratified. For this reason it is crucial that stage one should be introduced by the political decision to embark immediately on, and conclude as quickly as possible, intra-governmental negotiations on a Treaty, as well as a set of concrete measures aimed at effectively enhancing policy co-operation and co-ordination.

L-P: delete
Pöhl: delete
Duisenberg: delete

60. The second stage could begin when the [Treaty had come into force. This would involve the construction of the institutional framework of the economic and monetary union and, where envisaged, a gradual transfer of operational functions to the Community institutions. This stage is conceived as a period of transition to the final stage and is thus characterised primarily by a training process leading to a collective decision-making, but without yet abandoning the ultimate responsibility for policy decisions at the national level. [If stage two were conceived to last for a long period or if it were enacted without a clear understanding regarding a subsequent move to full economic and monetary union, the provisions of stage two would have to be designed differently.]

[Pöhl: new

L-P: delete

61. The final stage would commence with the move to irrevocably locked exchange rates and the attribution to Community institutions of the monetary and economic competences described in Part II of this Report. In the course of the final stage the national currencies would eventually be replaced by the ecu as the Community's sole currency.

5. The principal steps in stage one

62. In the institutional field this stage would involve the preparation and ratification of the Treaty on the economic and monetary union, with a procedure similar to the one followed for the Single European Act. [The decision to draw up a Treaty would be coupled with an official

L-P delete, or "in the institutional field, by the time of a transition to stage II, it would be necessary to prepare and ratify the Treaty...
Pöhl: [at a time to be decided in the light of progress made in the integration process in stage one
[ ] delete

announcement that the ecu should develop into the currency of the future monetary union in Europe.]

63. <u>In the economic field</u> the steps would centre on the completion of the internal market programme and measures to enhance the capacity for macro-economic management in the face of increasing market integration. In particular, there would be action in three directions.

Firstly, there would be a complete removal of internal barriers and liberalisation of exchanges of goods, services and capital within the Community, according to the internal market programme adopted in the Single European Act. The completion of the internal market would be accompanied by a strengthening of Community competition policy [and of the executive and judicial authority to identify and sanction infringements of Community law.]

L-P: delete

Secondly, there would be full implementation of the "Brussels package" for reforming and doubling the structural funds, designed to enhance substantially the ability of Community policies to promote regional development and to correct economic imbalances.

Thirdly, the 1974 Council Decision on economic convergence would be replaced by a new procedure that would considerably strengthen the possibilities for constraining budgetary imbalances, as well as for assessing the consequences and the consistency of the overall policies of the member states. Co-ordination would be based on recommendations and carried out taking due account of the views of the Committee of Governors. In particular, the revised 1974 Decision on convergence would:

<u>Ciampi</u>: this risks encroaching on the competences of other bodies

- establish a process of multilateral surveillance of economic developments and policies based on agreed indicators. Where performances are judged inadequate or detrimental to commonly set objectives, recommendations and policy consultations would take place at the Community level with the aim of promoting the necessary corrections in national policies;
- set up a new procedure for budgetary policy co-ordination, with increasingly precise quantitative guidelines and medium-term orientations;
- [define a programme of budgetary consolidation for member countries concerned [by reducing, where necessary, the [central]

L-P: delete
<u>de L</u>: [ ] general

government deficit to no more than X% of GNP over a period of Y years];

- provide for the possibility of promoting, where deemed appropriate, concerted budgetary action by the member countries.]

L-P: delete

64. <u>In the monetary field</u> focus would be placed on [implementing] financial integration and intensifying co-operation and co-ordination of monetary policies. Realignments of exchange rates would remain one of the instruments for adjusting imbalances among Community countries, but an effort would be made by every country to make the functioning of other adjustment mechanisms more effective. Actions would develop along several lines.

de Lar: removing all obstacles to

de Lar: indicate that realignments are no normal adjustment instrument but an exceptional means sanctioning the absence of adjustment

Firstly, through the approval and enforcement of the necessary Community Directives, the objective of a single financial space in which all monetary and financial instruments circulate freely and banking, securities and insurance services are offered uniformly throughout the area would be implemented.

Secondly, [efforts would be made] to include all Community currencies] in the EMS exchange rate mechanism. The same rules would apply to all the participants of the exchange rate mechanism.

de Lar [ ] it would be important to

Pöhl: [ ] all Community currencies should be included

[Thirdly, all regulatory impediments to the voluntary use of the ecu as a common numeraire and a means of settlement by private economic agents would be removed.]

Pöhl: delete, because it involves multilateral change

Fourthly, the 1964 Council Decision defining the mandate of the Committee of Central Bank Governors would be replaced by a new Decision giving the Committee greater ~~authority and~~ prominence and/[making it the forerunner of the Council of the European System of Central Banks to be created under the new Treaty.] The thrust of the revision would be to strengthen the co-ordination of monetary policy among all member countries of the Community. To this end,] the Committee of Governors would:

L-P: [and a stronger voice in the economic policy making process of the Community and its member states. To this end the

Pöhl [ ] delete

- formulate [recommendations] on the overall orientation of monetary and exchange rate policy, [as well as on measures taken in these fields by individual countries. In particular, the Committee would be consulted in advance of national decisions on the course of monetary policy, such as the setting of annual domestic monetary and] credit targets. [In the event of speculative capital

Pöhl [ ] opinion

[ ] delete??

Pöhl delete

de Lar "

flows unwarranted by fundamentals or underlying monetary policy, the Committee could declare publicly, that the European central banks stood ready to counteract these capital flows by interventions;]

- make policy recommendations to individual governments and the Council of Ministers on ~~non-monetary~~ policies that could affect the internal and external monetary situation in the Community, especially the functioning of the EMS. The outcome of the Committee's deliberations could be made public by the Chairman of the Committee;

de Lar.: delete

- submit an annual report on its activities and on the monetary situation of the Community to the European Council and the European Parliament.

The Committee's opinions and recommendations would not have to reflect unanimity, [but could be established by a qualified majority]; the recommendations would not/be binding. [In order to reinforce the monitoring and the analysis of monetary and economic developments the Committee would:]

de Lar.: (delete [have to reflect unanimity and would not be binding

Pöhl: delete

de Lar.: The governors, members of the Committee, have decided to reinforce the existing committees of experts and to support them by a permanent research staff. It is therefore essential at this very first stage to create an appropriately strong research structure and advisory function in the fields of monetary policy, foreign exchange policy and banking supervision.

- set up three committees (supported by a permanent research staff) which would report regularly to and advise the Committee of Governors. A monetary policy committee would define common surveillance instruments, propose harmonised objectives and instruments and help to gradually induce a change-over from ex post analysis to an ex ante approach to monetary policy co-operation; a foreign exchange policy committee would monitor and analyse exchange market developments and assist in the search for effective intervention strategies; [should these two committees possibly be merged into a single one in order to facilitate an integrated approach to monetary policy?] a committee on banking supervision would hold regular consultations on matters of common interest in this field.

[Finally, efforts would be made to increase the independence of national central banks.]

L-P: delete

de Lar.: keep this idea

(-P: delete or shorten (only the first 12 lines!)

65. A number of Committee members advocated the creation of a <u>European Reserve Fund (ERF)</u> that would foreshadow the future European System of Central Banks. The main objectives of the ERF would be:

- to serve as a training ground for implementing a better co-ordination of monetary analysis and decisions;
- to facilitate, from a Community point of view, the concerted management of exchange rates and possibly to intervene visibly (in third and participating currencies) on the foreign exchange market upon request of the participating central banks;
- to be the symbol of the political will of the European countries and therefore reinforce the credibility of the process towards economic and monetary union.

The resources of the Fund would be provided by a pooling of a limited amount of reserves (for instance 10% at the start) by participating central banks and require a permanent structure and staff in order to achieve its tasks, i.e.:

- management of the pooled reserves;
- interventions on the exchange markets decided by the members;
- analysing, from a collective perspective, monetary trends in order to enhance policy co-ordination.

All EC central banks would be eligible to join the Fund. However, membership would be subject to their participation in the exchange rate mechanism, the reason being that the EMS implies specific constraints on monetary policy and foreign exchange interventions that both require a common approach of the central bank concerned.

The management of the ERF would consist of:

- a Board of Directors which would comprise automatically the Governors of each central bank participating in the ERF;
- an Executive Committee whose members would be selected by the Committee of Governors on the basis of competence. This Executive Committee would be of a small size, consisting of three or four

members who would have direct responsibility for the different departments of the ERF;

- the ~~two~~ three Committees: a Foreign Exchange Policy, ~~and~~ a Monetary Policy Committee~~s~~ and a committee on banking supervision
- two departments: a Foreign Exchange and Reserves Management Department, and a Monetary Policy Department.

delete

66. Other members of the Committee felt that the creation of a ERF was not opportune at this stage. Their reservations stem from the fact that:

- too much emphasis is placed on external considerations, [fostering the illusion that common interventions by such a Fund could be a substitute for economic adjustment to correct imbalances within the Community or would offer individual countries more leeway in their domestic monetary policy;]
- the proposal involves an institutional change which, in accordance with Article 102A of the amended Treaty of Rome, would fall under the procedure stipulated in Article 236 and require a new Treaty; the adoption of an alternative procedure, such as an inter-governmental agreement among the member countries concerned, as well as the setting-up of the Fund under the same procedures as were applied to the establishment of the EMS are not considered possible;
- it would be counterproductive to set up a new institution for a limited period of time, in particular if most of the functions of the Fund could be performed by the Committee of Governors if it were given wider powers;
- [it would institutionalise the separation of the Community into two groups of countries.]

[However, the Committee members opposed to the immediate creation of the ERF could envisage some pooling of reserves and intervention operations at a later stage, but before the definite locking of parities.]

delete: [ ] one must not think that these interventions could be a substitute for economic adjustment

delete: they consider that some functions of the Fund could be performed by the Committee of Governors, if it were given wider powers; thus there is no need to set up a new institution immediately.

Pöhl: redraft

Duisenberg: redraft

delete it would, at the start institute the separation of the Community into two groups of countries

L-P: unacceptable

Pöhl: delete

Duisenberg: delete

6. The principal steps in stage two

67. In the institutional field the basic organs and structure of the economic and monetary union would be set up in accordance with the Treaty, involving both the revision of existing institutions and the establishment of new ones. The institutional framework would gradually take over operational functions, serve as the centre for monitoring and analysing macro-economic developments and promote a process of common decision-making, although the ultimate policy responsibility would still remain in the hands of the national authorities. However, as stage two represents a learning process allowing the Community to gain experience with operating in a new institutional setting and to approach progressively the conditions of economic and monetary union, it would be crucial that certain operational decisions were made by qualified majority. [In order to ensure that this would not imply a relinquishment of national policy autonomy, the adoption of a qualified majority would have to be confined either to the use of instruments whose impact on economic developments is negligible or to decisions which do not hinder national authorities.] L-P: delete

68. In the economic field the Council and the Commission ~~with some involvement of~~ and the European Parliament would reinforce their action along three lines. Pöhl: — and

Firstly, with regard to the single market and competition policy the results attained through the implementation of the single market programme would be consolidated and, wherever needed, completed.

Secondly, an evaluation of the implementation of the "Brussels package" would be made and a new programme of structural and regional actions would be adopted [and the resources for supporting the structural policies of the member states would be enlarged. Community investment programmes in research and infrastructure would be strengthened.] L-P: delete

Thirdly, in the area of macro-economic policy, the provisions set up in the first stage through the revision of the 1974 Decision on convergence would be further strengthened by the adoption of guidelines decided by a qualified majority. Under this procedure the Community would:

Ciampi
- States clearly that a fundamental element is the setting up of an operational structure assuring joint management of monetary policy
- Wishes reference to his proposal as an example and illustration of the need for joint operations
- Another reference required → pooling of reserves + of responsibilities e.g. envisaged in ELF proposal
- Supports Thygesen redrafting in [illegible]
- Wishes to amend Duisenberg proposal: to amend 75-76, to make the procedure more clear, drop 77

L-P. too much detail on stages II + III
Wishes these to be replaced by his text, paras 20-33

- set a medium-term framework for key economic objectives with a follow-up procedure for monitoring performances and intervening when significant deviations occurred;
- set progressively more precise - although not yet binding - rules relating to the size of budget deficits and their financing; →
- on the basis of its present representation (through the member states or the Commission) in the various fora for international policy co-ordination, the Community would assume a more active role as a single entity in the discussion of questions arising in the economic and exchange rate field.

Pöhl: add: the Commission should have the responsibility of bringing before the Council any non-compliance by member states and should propose action as necessary.
Duisenberg: add
(4)

69. In the monetary field the European System of Central Banks - having all the principal features described in Part II of the Report - would be set up and would absorb the previously existing institutional monetary arrangements (the EMCF, the Committee of Governors, the committees for monetary policy analysis, foreign exchange policy and banking supervision, and the permanent Secretariat). The most important feature of this stage would be that the functions of the ESCB in the formulation and operation of a common monetary policy would gradually evolve as experience was gained. Exchange rate realignments would remain an instrument of adjustment, but there would be an understanding that the frequency and the extent of realignments should be steadily reduced. Some possible schemes for co-ordinating monetary policies in the course of this stage are discussed in the Annex to the Report.

de La: indicate that ex-re-adjustments are not a normal instrument of adjustment

Initially the ESCB framework would be used: as a joint facility to be shared by national central banks for implementing national monetary policy through operations in domestic and foreign exchange markets; as a centre for monitoring and analysing domestic monetary conditions and foreign exchange market developments; as a centre for the co-ordination of national monetary policies. [In the course of this stage the procedures would be altered in such a way as to capture the entire monetary operations of national central banks in their accounts and their transactions with the ESCB.]

L-P: delete

[In addition, a number of actions [would] be taken in stage two.

[Firstly, a certain amount of exchange reserves [would] be pooled and ~~would~~ be used to conduct limited exchange market interventions in

L-P [ ] might (twice!)

Pöhl [ ] delete

Duisenberg: add Any majority decision by the ESCB presupposes action by member states to ensure that central bank governors in their position as members of the ESCB Council should act independently of their governments.

accordance with guidelines established by the ESCB Council. Such guidelines would be determined by qualified majority.

Secondly, general monetary targets would be set for the Community as a whole, with a [presumption] that national monetary policy would be executed in accordance with these global guidelines. The general monetary targets would be set by the ESCB Council on the basis of a qualified majority decision.

ok for [ ] understanding

Thirdly, while the ultimate responsibility for monetary policy decisions would remain in the hands of national authorities, the operational framework necessary for deciding and implementing a common monetary policy would be created and experimented with. In this context ecus issued by the ESCB could be used as reserve instruments. The decision on the amount of ecu reserves to be issued could be made on the basis of a qualified majority. But under the experimental scheme the minimum reserve requirement would not yet be compulsory. This scheme is described in greater detail in the Annex to this Report.

Fourthly, regulatory functions would be exerted by the ESCB in the monetary and banking field in order to achieve a minimum harmonisation of provisions (such as reserve requirements or payments arrangements) necessary for the future conduct of a common monetary policy.

Fifthly, the margins of fluctuation within the ERM would be narrowed as a move towards the final stage of the monetary union, in which they could be reduced to zero.

[Still to be discussed: voting procedure in the ESCB Council in stage two.]

7. The principal steps in stage three

70. In the institutional field there would be the full attribution of competences to Community institutions, as foreseen in the Treaty.

71. In the economic field the transition to this final stage would be marked by three developments.

Firstly, there would be a further strengthening of structural and regional policies of the Community. Instruments and resources would be adapted to the needs of the economic and monetary union.

Secondly, the rules and procedures of the Community in the macro-economic and budgetary field would assume a binding character.

In particular, the Council of Ministers and the Commission ~~(in co-operation with~~ the European Parliament) would have the authority to take directly enforceable decisions, i.e.: Pôle: , under the control of

- to impose constraints on national budgets to the extent to which this is necessary to prevent imbalances that may threaten monetary stability;
- to make discretionary changes (through a procedure to be defined) in Community resources to supplement structural transfers to member states or to influence the overall policy stance in the Community;
- [to propose discretionary changes (through a procedure to be defined) in the level of harmonised taxation rates;] (-) : Ciller
- to apply some form of conditionality to existing Community structural policies and to Community loans (as a substitute for the present medium-term loans facility);

Thirdly, the Community would assume its full role in the process of international policy co-operation and a new form of representation in arrangements for international policy co-ordination and in internal monetary negotiations would be adopted.

72. <u>In the monetary field</u> the irrevocable locking of exchange rates would come into effect and the transition to a single monetary policy would be made, with the ESCB assuming all its responsibilities as foreseen in the Treaty and described in Part II. In particular:

- concurrent with the announcement of irrevocable fixing of parities between the Community currencies, the formulation and implementation of monetary policy in the Community would be conducted by the ESCB, with its Council and Board exercising their statutory functions;
- decisions on exchange market interventions in third currencies would be made entirely under the responsibility of the ESCB Council in accordance with Community exchange rate policy; the

de Lar:

execution of interventions would be entrusted to ~~[one or ?]~~ either to national central banks or the European System of Central Banks.

- technical and regulatory work would be done to prepare the transition to the ecu as single currency of the Community.

The change-over to the single currency would take place during this stage.

Pöhl: add section on follow-up procedures

Duisenberg "

de Lar: redraft of 75:

Simultaneously it is decided to launch a negotiation on a revised Treaty in an inter-governmental conference to be called for by the Heads of State. In the framework of this negotiation the competent Community bodies will make concrete proposals on the basis of this report concerning the second and the final stage. This proposal will be embodied with the appropriate legal considerations in the revised Treaty.

76: first sentence, after "on a basis" replace text by: "which will involve those immediately responsible in the member countries"