BANK FOR INTERNATIONAL SETTLEMENTS

CH-4002 Basle, 29th March 1989

Mr. Joly Dixon
Financial and Economic Advisor to President
Commission des Communautés Européennes
200, rue de la Loi
B-1049 Bruxelles

Dear Joly,

Please find attached the passages of the Report which the Chairman would like to have in reserve.

Yours sincerely,

Gunter D. Baer

Enclosure

Summary of monetary union

24. In <u>summary</u>, 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) <u>Pöhl</u> suggests to omit reference to the ecu.

Advantages of the single market

[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 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.]

(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.

Summary of economic union

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.