COMMITTEE FOR THE STUDY OF
ECONOMIC AND MONETARY UNION

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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."

Foreword

At its meeting on 27th to 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 decision 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.

~~The Report is organised in three main parts~~. The first one examines the present state of and perspectives for economic and monetary integration in the Community. The second part describes the principal features of the final stage of economic and monetary union, and the third part makes concrete proposals with regard to steps which could lead the Community in three stages to economic and monetary union.

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Rev. 1.3.89 Matthias Bsl. -

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

1. Introduction

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 ~~end of the~~ transition period leading to ~~the completion of~~ the customs union, ~~and~~ the setting up ~~definition~~ of the common agricultural policy, It presented a first attempt to define and set out a plan for the attainment of economic and monetary union.

major achievements of the Community in the '60s: the completion of

the creation of a system of own resources.

~~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. ~~Nevertheless~~ Several important institutional moves ~~had been made~~ 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. Nevertheless, by

followed the Werner Report:

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 ~~of the 1992~~ internal market programme and the signing of the Single European Act.

, in 1985, of the

The fact that the 1992 internal market process ~~has now become practically irreversible~~ 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.

is now well under way

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

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

3. ~~In the monetary field a new phase in the process towards an economic and monetary union opened with the creation of the European Monetary System at the end of the 1970s.~~ 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 ~~Community has~~ developed into 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 ~~acceptance of a stable~~ exchange rate constraint has greatly helped 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 in many countries a moderation in cost increases 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 facilitated and strengthened intra-European trade, even at times of severe economic difficulties and high unemployment.

the participants in the Exchange rate mechanism (ERM) have

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The EMS has served as a 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, while not changing its institutional setting.

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5. An important element in the launching of the European Monetary System was the creation of the ECU. In ~~setting up~~ the EMS, the European

creating

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 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 ~~functioning~~ operating mechanisms of the EMS.

By contrast, the ECU has gained remarkable popularity in the market place where its use as a denomination of financial transactions has spread significantly. A wide set of ECU instruments is now available for investors, both at the short and the long end of the market. In international banking the ECU ~~occupied~~ is at present ~~the place of~~ 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 to develop and tap the market for ECU securities, but it must also be attributed to an important extent to the ECU's attractiveness as a means of portfolio diversification and hedge against currency risks. Moreover, the creation of an ECU clearing system two years ago, in which by now more than thirty commercial banks 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 invoicing and settlement of commercial transactions remains limited, covering at present only about 1% of the Community countries' external trade. However, opinion polls, especially among firms, tend to show an increased interest in the potential uses of the ECU.

3. <u>The Single European Act and the Internal Market Programme</u>

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 ~~May~~ January 1985 by the Commission, to realise the objective of a market without internal frontiers by 1992. The essence of the measures for the removal of physical, technical and tax barriers was

set out in a White Paper, which specifies the 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.

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7. The Single Act signalled ~~two significant~~ changes in the Community's strategy to advance 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, gave the European Parliament a greater role in the legislative process, ~~and~~ 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. ~~Secondly,~~ with the Single 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.

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Secondly, it

This new approach to market integration represented a decisive and innovative move towards deregulation and lighter public sector intervention in economic activity. Thirdly,

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 until 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. The most prominent, and

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certainly one of the most important, ~~examples~~ 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. Rapid and significant progress has ~~also~~ been made in removing technical barriers relating to machines, materials, foodstuffs, public works and supply contracts, sea, air and road transport, ~~and financial services~~. The abolition of tax barriers and physical barriers has advanced less quickly so far.

steps towards the single market

to page 4 ⊛

in achieving mutual recognition of diplomas and in

9. The creation of a single market is, however, not solely based on the elimination of ~~micro-economic market~~ barriers but comprises also a ~~range of measures~~ to avoid market segmentation through restrictive commercial practices and dominant market positions, as well as common policies aimed at ~~reducing market imperfections~~. 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.

physical, technical and tax

an improved competition policy

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.

As far as complementary common policies are concerned, the European Council approved in February 1988 a package of measures which dealt with both the most urgent and arduous European policy issues and Community policies directed at ~~market imperfections~~ and safeguarding the economic and social cohesion of the Community. The package included three major elements. Firstly, ~~measures to reform the~~ common agricultural policy ~~in the light of new production and trade conditions~~. 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 developments in the single market. Most importantly, the structural funds will be doubled by 1993 and together with a reorientation of policies away from project to programme financing will enable the Community to promote more effectively growth and adaptation in less

common goals

an adaptation of

to the general conditions of the world market and to the need of preserving a diversified and diversified agricultural sector in Europe.

and regional

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 them 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 a growing industrial co-operation. These developments have generated a new dynamism and ~~certainly~~ contributed to the recent acceleration of economic growth in the Community.

have

11. The single market will entail profound structural changes in the economies of the member countries. The abolition of ~~market~~ 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 the potential gains can only materialise if economic policy ~~[illegible]~~ ~~adjusted in~~ response to the structural changes. The opportunities arise because the unified enlarged economic space greatly increases the freedom of choice of market participants, generates large possibilities for exploiting economies of scale and comparative advantages ~~and~~ reduces the administrative costs of intra-Community trade. 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,~~ The extent to which these gains can be achieved depends critically on the degree of certainty surrounding the decision-making of private

internal

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– at both the national and the Community level – gives the appropriate

and enlarges the margins of manoeuvre for macroeconomic policy.

The reduction in cost of production will stimulate growth through an increase in purchasing power of economic agents.

soundness and consistency of the public policies

~~More systematic coordination of national economic policies is both a condition for the success of the single market and a difficult result to achieve on the basis of a voluntary exercise.~~ Policy decisions faced by national authorities in the economic as well as in the monetary field are subject to so many pressures and institutional constraints that even the best efforts to chose a course of action that is mindful of international repercussions and influences at times is ~~bound~~ to fail. By giving uncertain or contradictory signals to market participants and by generating divergent trends, a failure in cooperation would weaken the single market and create the danger of negative chain reactions. This is why an entirely voluntary nature of the procedures would be too fragile a foundation to build permanently on it the necessary increase in coordination.

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- reduce the room for independent policy manoeuvre

market participants. The single market will greatly strengthen economic interdependence between member countries and amplify the cross-border effects of development originating in each member country. If national policies are not ~~brought in line~~ 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 ~~in which~~ ~~national authorities determine economic policies~~ thus imposes a ~~constraint on their room for independent manoeuvre and requires a~~ ~~higher degree of policy co-ordination.~~ This is most obviously the case in the field of monetary policy where ~~in a situation of~~ freedom of capital movement and integrated financial markets, incompatible national policies would translate quickly into exchange rate pressures. But it also applies to all other areas of national economic management

composed into a credible and consistent framework

very

and the desire to draw from it all its potential benefits in terms of economic and social well being

significant stepping up in the intensity and effectiveness of the process of policy coordination between separate national authorities.

which affect aggregate demand and costs of production

Even close co-operation between national authorities can, however, not 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.

12. ~~As~~ The success of the internal market programme thus hinges to a decisive extent on ~~more effective Community policies as well as a close~~ co-ordination of national economic policies, ~~it~~ 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. As will be ~~discussed~~ in Part II of the 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 coherent and effective economic management for the Community as a whole. In this sense economic and monetary union will add to the internal market programme two principal elements. Firstly, it will set up explicitly a policy framework which will replace the present ad hoc procedures for

a much closer

as well as on effective Community policies. This

explained

It also implies that serious consideration should be given to the limits of voluntary coordination. ... insert (X)

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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 enhance strongly the potential of the single market. 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 ~~will~~ secure a significant increase in economic welfare in the Community. This would derive from three interrelated developments. would

13. ~~The benefits of economic and monetary union would derive from three interrelated developments.~~ 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, 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.

14. Secondly, a ~~closely co-ordinated~~ management of macro-economic policies is not only vital for the cohesion of an economic and monetary union, but it also ~~offers the possibility of~~ systematically ~~exploiting~~ the reciprocal room for manoeuvre under a co-operative strategy ~~and attaining~~ 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

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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 ~~would be~~ 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.

, which is already calculated in the order of ... %, could be further

, equivalent to about ... jobs,

15. Thirdly, in leading to a single currency area an economic and monetary union would establish the conditions under which a common market could fully develop its potential. ~~As~~ a single currency area ~~would imply the permanent fixing of exchange rates — or the adoption of a single currency —~~ participants in the single market would benefit strongly 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 transparency of prices and, therefore, the pressure to avoid price discrimination would be increased. These three consequences would not only provide greater certainty for economic decisions and planning, they would also reinforce strongly 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.

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The adoption of permanently fixed exchange rates would, however, eliminate an important indicator of policy ~~conflicts~~ 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 ~~directly the level of real wages~~ 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

inconsistencies

the structure of the economies and the costs of production, change on the way to economic and monetary union, but the ~~resultant loss of the degree of freedom~~ would 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, external shocks would normally not affect the entire economy of a single member country, but rather manifest themselves in specific ~~industrial~~ sectors throughout the Community, ~~and~~ the appropriate remedial action would be in the form of structural policies instead of exchange rate change. Sizable imbalances among Community countries would only emerge if individual countries embarked on incompatible policy courses, but ~~if this were possible for any extended period, policy co-ordination would have failed and the very foundations of an economic and monetary union would have been destroyed.~~

effect of this change

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not only to provide stability in exchange and financial markets, but also

but this is precisely what should be impeded by moving from ad hoc voluntary cooperation to the new set of rules, procedures and institutional arrangements that characterize the economic and monetary union

16. The move to economic and monetary union would ~~also~~ increase considerably 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 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.

17. 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, ~~does not require the establishment of an economic and monetary union~~ requires ~~however~~ a ~~significant increase~~ in the degree of economic policy co-operation even in areas that are not, as such, part of the single market programme. Such an increase represents ~~a significant~~ progress on the path leading to an economic and monetary union. ~~This is the reason why the~~ European Council in Hannover ~~has decided~~ to consider again the problem of an economic and monetary union and the steps leading to it. ~~These are the subject matters of Parts II and III of this Report.~~

stepping up

It is the relationship between the desire to draw maximum benefits from the single market programme and the need to step up economic and monetary cooperation that has led the

In order to clarify first the essential features and implications of the completion of an economic and monetary union the next Part of this Report examines the final objective and describes the economic and institutional conditions under which be achieved. The following Part ~~Stage~~ presents a pragmatic step-by-step approach to that final objective.

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 were necessary, whereas all policy functions which could be carried out at national (~~or~~ 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 policy ~~decisions~~ functions to be taken at the Community level would arise primarily in the ~~field~~ of 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 ~~field of fiscal policy~~ a wide range of ~~budgetary~~ decisions would ~~as left to~~ national ~~authorities on the decisionmaking~~ would have to be placed into framework of binding rules which would enable the Community to determine an overall ~~fiscal~~ policy stance, avoid major differences in public sector borrowing requirements between individual member countries and observe certain constraints with regard to the financing of budget deficits.

21. A step-by-step approach to implementing an economic and monetary union can be set out only if there is a clear understanding of ~~this~~ final objective, of its implications for the working of the economy and economic policy decisions, and of the principal elements that 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

and local authorities acting through their traditional channels and instruments. However, given the impact that they may have on the overall economic situation of the Community, such decisions

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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

22. 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: ( ) x ?

- 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 were taken to lock irrevocably the exchange rates between Community currencies. 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 closer 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.

23. 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 <u>a single currency</u>, 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, greatly facilitate the monetary management of the Community and have a much higher weight in international markets than any individual Community currency. In this connection, it would be desirable to endorse the idea that the 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 ~~i.e. that~~ any debt contracted in ECU before the introduction of the single currency would be payable at face value in ECU 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 ~~serve as a means of payment, unit of account and store of value~~ for all residents of the Community. The ~~introduction of~~ a single currency would ~~however, be possible only some time after exchange rates had been locked, when~~ economic agents had become sufficiently acquainted with the ECU and ~~when~~ its use in commercial and financial transactions had spread.

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24. 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 the <u>need for a single monetary policy</u> 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 the responsibility for monetary policy to a new institution, the European System of Central Banks, (the principal features of which are outlined in Section 4), 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 an unambiguous procedure for setting specific objectives of the Community's aggregate monetary policy; and secondly, instruments would have to be developed with which the compliance of national monetary authorities with the commonly taken decision could be ensured.

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 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 strengthen progressively. Once every banking institution in the Community is free to accept deposits from and 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.

have to

single market in combination with irrevocably fixed exchange rates or a single currency

25. As has been pointed out in Part I of this Report, the ~~decision to lock exchange rate parities between national currencies irrevocably~~ would have profound effects on the functioning and the performance of the economy of the Community.

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~~ thus contributing to the evolution of a more homogeneous economic structure in the Community and ~~reduce~~ reducing the susceptibility of the Community to external shocks.

At the same time, however, exchange rate realignment would (*) ~~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, while the exchange rate would no longer serve as an instrument for adjusting economic imbalances among member countries, there would still be the possibility of divergences between the supply of and demand for economic resources in individual Community countries.~~ ~~However,~~ Also, the statistical measurement and the economic interpretation of ~~such~~ economic imbalances might become more difficult ~~and balance-of-payments disequilibria would essentially reflect regional imbalances~~ because in a fully integrated market ~~and as a consequence,~~ 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 guidepost for policy-making. ← # from p. 18

p. 19

~~However,~~ 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 were coupled with measures designed to strengthen the mobility of factors of production and a close co-ordination of economic policies.

* go to page 18

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 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, measures to co-ordinate effectively policies in non-monetary areas.

3. The principal features of economic union

22. 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 by 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
- binding rules for budgetary policies.

macroeconomic policy co-ordination, including and arrangements

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

Firstly, the economic union should be inspired by the same market 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.

oriented

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.

28. The measures aimed at <u>creating the single market</u> are to a large extent envisaged in the EC Treaty and the Single 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.

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 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.

[illegible] the improvement [illegible] the quality of production factors and for

* new para. 29 (from page 16)

~~29. As has been discussed in Part I of this Report the single market in combination with irrevocably fixed exchange rates or a single currency would benefit from a monetary environment of greater certainty that would further enhance the advantages of an enlarged economic space. However, as previous historical experience has shown - it would also encounter <u>certain economic constraints</u>, due to the fact that exchange rate realignments would~~

// economic management

to p. 16 (*)

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, ~~technological~~ and ~~regulatory~~ 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 non-monetary policies pursued at national levels. ~~As was pointed out earlier,~~ In a monetary union 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.

+ taxation
= tax

to p 16 #

30. ~~It is primarily for these reasons that~~ The creation of an economic and monetary union would need to complement the creation of a 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 needs to be reinforced or complemented; ? ~~and~~ binding rules in the budgetary field and other arrangements both to limit the scope for ~~macro-economic~~ divergences between member countries and to design an overall economic policy framework for the Community as a whole.

[ ] ×

? macroeconomic co-ordination, including

31. Competition policy - conducted at the Community level - would have to operate in such a way that access to markets were not impeded and market functioning not 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. ~~In particular,~~ Attention would have to be paid to the problem of excessive government subsidies ~~in favour of certain industries since state aids~~ do not merely distort competition but result in the longer run in an inefficient use and allocation of scarce economic resources.

+ to the extent to which they

~~In addition to clearly formulated policies for the dismantling of barriers and the prevention of restrictive practices,~~ efforts would ~~also~~ have to be made to convince European management and labour of the advantages of gearing wage policies largely to improvements in productivity and thus to contribute or accept a uniform minimal rate of price increase at the Community level. Governments on their behalf should strehgthen tendencies towards reducing or completely eliminating direct intervention into the wage and price formation process.

(*) insert in p. 23

32. <u>Community policies in the regional and structural field</u> would be of ~~imperative~~ importance in order to promote an optimal allocation of resources and ~~a balanced distribution of wealth~~ 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 implications of other Community policies would have to be taken into account.

paramount
to spread welfare gains

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 ~~would differ considerably and might therefore~~ be difficult to assess: on the one hand, economic integration would provide less developed regions with lower wage levels, 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

may
and social costs

with adequate financial resources which would allow it to assist 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 leading to ~~1992 and~~ emphasis will be shifted from project to programme financing. In the process of creating economic and monetary union such policies would have to be strengthened further after 199~~2~~.

1993,

, and a system of partnership was established between the Community and the receiving regions.

/3

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 the conditions for production through investment programmes in such areas as physical infrastructure, communication, transportation and education so that large-scale movements of labour would not become the major adjustment factor. The success of these policies would hinge not only on the size of the available financial resources, but to a decisive extent also on their efficient use and ~~with due regard~~ to the ~~profitability~~ of the investment programmes. Indeed, the more recent experience of countries inside and outside the Community has shown that structural and regional development programmes were particularly successful when improvements in the resource base of regions encouraged by investment in infrastructure and education were 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.

private and social return

~~As was mentioned above, a satisfactorily balanced regional development would also have to be supported by other economic policies~~. In certain areas such as ~~transport,~~ research and technological development, and environment, the EC Treaties as amended by the Single Act have laid the foundations of Community policies, ~~which~~ would not only enhance market efficiency, but could also ~~be employed with a view~~ to regional development. Subject to the limits of the principle of subsidiarity, such policies would have to be ~~expanded further~~ in the process to economic and monetary union.

infrastructure,

contribute

developed

and offset market imperfections,

aimed at common goals. Such policies

Sufficient wage flexibility and labour mobility ~~could also help to ease regional problems and~~ contribute to avoiding changes in competitiveness in different regions 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 at conditions that would prompt the recipient to intensify its adjustment efforts.

should

and countries

33. Macro-economic policy ~~developments~~ are the third area in which action would be ~~required. While policies to ensure a proper distributional and allocative functioning of the market without frontiers would have to be formulated and, in part, executed at the Community level, many of the~~ developments on which macro-economic conditions depend would continue to be determined by factors and decisions operating at the national level. This would apply not only to wage negotiations and other ~~market-determined behaviour, but in particular also to budgetary policies~~. Aside from the system of binding rules ~~governing the size and the financing of national budget deficits, decisions on the~~ level and composition of government spending ~~and~~ 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 ~~decisions were taken that~~ major public goods constituting the bulk of public sector activity ~~(internal and external security, justice, social security, environment) would~~ were attributed to a large extent ~~be provided at~~ the Community level would the Community budget be significantly enlarged.

economic behaviour in the fields of production, savings and investment but also to the action of public authorities in the economic and social sphere.

necessary in order to have a viable economic and monetary union and to draw from it ~~the~~ maximum benefits. This will require an appropriate definition of the role of the Community in the coordination of economic policies.

The major

that will be mentioned below, decisions on the main components of public policy in such areas as internal and external security, justice, social security, education, and hence on the

However, an economic and monetary union could only operate on the basis of mutually consistent and sound ~~prudent~~ 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. ~~This is why all countries would have to accept that sharing a common market and a single currency area imposes narrow constraints on budgetary policies and requires strict fiscal discipline.~~ Similarly, strong divergences in wage levels not justified by different trends in productivity would produce economic ~~and monetary~~ tensions, and pressures for monetary accomodations.

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 would 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 facilitate the financing of economic imbalances. Rather ~~In particular, in the financial field, 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.

In the general macroeconomic field an overall assessment of the short- and medium-term economic developments of the Community should be agreed periodically and constitute the framework for a better coordination of national economic policies. The Community should be in the condition ~~For this reason an economic and monetary union would require binding arrangements which would enable the Community~~ to monitor its overall economic situation, to assess the consistency of developments in individual countries and with regard to common objectives and to formulate guidelines for policy. ~~This would be particularly important for budgetary policies.~~

In the wage and industrial relations field the autonomous negotiating process of social partners should be preserved and strengthened in view of the role it plays in improving the prospects for growth and employment. To this end... ⊗ p. 20

In the budgetary field, particular arrangements are 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 ~~particular~~ 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 ~~monetary financing~~ 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.

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

- the creation of an internal market without physical, regulatory or fiscal frontiers, supplemented by a competition policy which effectively removes distortions in competition;
- common policies in ~~transport,~~ research and technological development, which would help to exploit the full potential of the single market and its role in the allocation of resources;
- a system of ~~financial transfers~~ to stimulate regional and structural developments through investment programmes, which would help regions with lower productivity to catch up with the more developed parts of the Community;
- a framework for monitoring and co-ordinating general short term and medium term ~~macro~~economic developments in the Community with a view to attaining non-inflationary, balanced economic growth;
- binding rules setting maximum possible deficits for national budgets taking into consideration the situation of each member country, and ~~strict~~ limits on both monetary financing and borrowing in third currencies.
- effective an binding procedures ~~for the~~ co-ordination ~~of national budgetary policies~~ which would enable the Community to determine its macro-fiscal policy stance policy, to

~~These requirements would not only have to be met in order to derive the greatest possible benefit from an enlarged economic space, they would also be indispensable for the cohesion of the monetary union.~~

infrastructure,
environment
complement
policies
plurianual

more resources ?

- a consideration of the social dimension of the European Community

pose

x ?

4. Institutional arrangements

35. Management of the economic and monetary union therefore 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 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). ~~The~~ Although the establishment of economic union would not necessarily require the creation

of a new institution, ~~but~~ 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.

36. The need for a new monetary institution ~~would arise~~ arises because a single monetary policy could not be decided and implemented independently by different central banks and because ~~decisions concerning~~ day-to-day monetary policy operations ~~would have to be centralised if they were to~~ can respond quickly to changing market conditions only if they are decided 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 for the purpose of providing the European economy with an efficient single currency area. 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 formulate 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.

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

insert (*) from p. 26

Status

- independence of instructions from national governments and Community authorities;
- a proper democratic legitimisation through reporting and appointment procedures;
- appointment of the members of the Board by the European Council on proposal by the ESCB Council; the tenure of Board members would be for five to seven years and it would be irrevocable;
- transmission of an annual report by the ESCB to the European Council ~~of ministers~~ 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;

Structure and organisation

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

goes to p. 25 *

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 ~~regional~~ national level and for the maintenance of a properly functioning payment system; the System would be committed to regulate the amount of money in circulation and 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 co-ordination of banking supervision policies of the national supervisory authorities;

for the full convertibility of European currencies,

Policy instruments

- the instruments available to the System would be specified in its statute, together with a procedure for amending them; 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 of lending to all public authorities;

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

37. The institutional requirements for effective conduct of economic policies should be assessed in the light of the functions which would be performed at the Community level. As noted in the previous section, there would be four broad areas in which the Community would have to be involved: firstly, the establishment and maintenance of a single market for persons, goods, services and capital; secondly, competition policy and other measures aimed at strengthening market mechanisms; thirdly, the formulation and implementation of common policies aimed balancing the process of market integration; and fourthly, co-ordination of macro-economic policies, in ~~particular with a view to applying a framework of binding~~ rules which would enable the Community to enforce budgetary restraint and to avoid major differences in public sector borrowing requirements between individual member countries, to follow a common policy with regard to the financing of ~~budget deficits and to formulate a macro-fiscal policy stance of the Community~~.

Insert

~~The necessary institutional framework for performing these four tasks is already in place with different, though partly overlapping, functions conferred on the Council, the European Parliament, the Commission and the Court of Justice.~~ In order to ensure a flexible and effective conduct of policies in those economic areas in which the Community would be involved, ~~two~~ basic requirements would have to be fulfilled: ~~[illegible]~~ - 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. ~~Secondly, in those areas in which the Community's role would be to co-ordinate policies, its task would have to involve the application of a system of binding rules to individual member states.~~ 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 the Council of Ministers and the Commission could be envisaged in the economic field;

three

#

Insert

~~In order to be able to carry out their functions within the existing institutional framework, the Community bodies would have to possess adequate instruments and means. As far as the implementation of the single market and competition policy is concerned, the necessary procedures and arrangements have been laid down in the Treaty of Rome and the Single Act, conferring upon the Community the legislative, executive and judicial authority.~~

Community policies in the regional and structural field

~~With regard to common policies aimed at strengthening the functioning of the single market,~~ The foundations for a more effective Community role in regional and structural development ~~had~~ 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.

Macroeconomic policy

~~In order to enable the Community to pursue an appropriate macro-economic policy,~~ This is the field where new procedures would have to be developed. ~~These procedures~~ Firstly, they would have to ~~define and maintain a fair~~ strike a balance between co-ordination through binding rules ~~fixing a set of objectives and constraints~~ and discretionary co-ordination adapted to a particular economic situation. ~~This would imply a need for~~ 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.

The broad objective of ~~macro~~ general economic policies would ~~also be to determine a strategy for~~ 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 ~~all~~ their economic and social implications; participating in the policy coordination 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 ~~economic and social cohesion~~ structural and regional development; and determining, in close consultation with the ESCB Council, the Community's exchange rate policy.

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

~~While the involvement of the Community in non-monetary policies would be based on the existing institutional setting, it would be of paramount importance that the ensuing policy decisions resulted in a coherent and consistent set of measures which would clearly signal the Community's policy stance. Without an unequivocal formulation of economic policies, in particular in the budgetary field, the responsibility for macro-economic policy for the Community as a whole would fall on monetary policy. This would leave the Community with only one macro-economic policy tool and therefore significantly impede an effective policy geared to stability and growth.~~

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 and regular relations between the existing institutions and the European System of Central Banks would have to be established which would provide for consistent consultation procedures without, however, impinging on the policy responsibilities entrusted to each institution in its own field of economic and monetary management. 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 a report each year to the European Council and the European Parliament on the functioning and the status of the economic and monetary union.

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.

(*) insert in page 27

37. Contrary to the monetary field, in the economic field an institutional framework for performing policy tasks is already in place, with different and ~~clea~~ complementary functions conferred to the Council, the European Parliament, the Commission and the Court of Justice. The problem therefore is not so much one of ~~designing~~ *designing the mandate, status and structure of a new institution as to complement and adapt the role of the existing institutions to the policy functions required by economic and monetary union. The new Treaty ~~would~~ would have to bring about this adaptation following certain general criteria and with reference to the four main policy areas described above.

General criteria

\# insert p. 27

– 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 and on a power – for* the Council or the Commission – to publicly denounce and sanction departures from the agreed policy line;

~~the Community should have the possibility to make discretionary changes in Community resources~~

– discretionary changes in Community resources, in the level of harmonized taxation rates and in the conditions attached to structural policies and Community loans should ~~be possible~~ become available instruments to and incentives in support of agreed ~~plus?~~ policies.

☒ insert on page 28

<u>Single market and competition policy</u>

For these two areas of policy, 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 dramatic easing of the overall burden of regulation to which they are subject, ~~[illegible]~~ for the Community institution the some 300 new directives that are necessary to create and maintain the single market will represent a heavy addition to their executive and policing functions. New instruments and procedures to grant to consumers as well as producers full respect of the rules of the ~~[illegible]~~ single market might prove necessary after 1992.