

# **ECONOMIC AND MONETARY UNION**

SEC (90) 1659

**COMMISSION OF THE EUROPEAN COMMUNITIES**

---

Communication of the Commission of 21 August 1990

The following pages were blank and are not reproduced: 2, 10, 16, 28, 36.

This publication is also available in the following languages:

ES ISBN 92-826-1821-8  
DA ISBN 92-826-1822-6  
DE ISBN 92-826-1823-4  
GR ISBN 92-826-1824-2  
FR ISBN 92-826-1826-9  
IT ISBN 92-826-1827-7  
NL ISBN 92-826-1828-5  
PT ISBN 92-826-1829-3

Cataloguing data can be found at the end of this publication.

Luxembourg: Office for Official Publications of the European Communities, 1990

ISBN 92-826-1825-0

Catalogue number: CM-59-90-928-EN-C

Articles and texts appearing in this document may be reproduced freely in whole or in part provided their source is mentioned.

*Printed in the FR of Germany*

# Contents

<b>Introduction</b>	5
<b>1. Benefits and costs of economic and monetary union</b>	11
1.1. Definition	11
1.2. Major benefits and costs	12
1.3. Benefits and costs in the processes of convergence and the transition	13
1.4. Overall evaluation	14
<b>2. Monetary union</b>	17
2.1. The choice of a single currency	17
2.2. General principles and organization	17
2.3. Internal monetary policy and the ecu	19
2.4. The ecu and external monetary policy	20
<b>3. Economic union</b>	21
3.1. Principles, objectives and coherence	21
3.2. Efficiency	22
3.3. Cooperation	23
3.4. Economic and social cohesion	25
3.5. Consequences for Community finance	26
<b>4. Transition</b>	29
4.1. The general conception	29
4.2. What is at stake in Stage I?	31
4.3. Consolidation of the EMS	32
4.4. The creation of the new monetary institution	33
4.5. The ecu	33

<b>5. Institutional aspects</b>	<b>37</b>
5.1. The creation of Eurofed	37
5.2. Economic provisions	38
5.3. Provisions for the transition	38
5.4. Balance between the institutions	38
5.5. The role of each institution	39

## Introduction

Progress towards economic and monetary union has a double significance for the current development of the European construction.

On the one hand, it can be seen as the natural complement of the full realization of the Single European Act and of the realization of the 1992 objective: the internal market without frontiers. From an economic and social point of view, the Member States and the citizens of the European Community will only fully benefit from the positive effects of the creation of the large common market and cooperation if they can use a single currency — the ecu — and if they are capable of reinforcing their cooperation, and consequently the convergence of their macroeconomic policies.

On the other hand, to be fully effective, economic and monetary union requires a qualitative institutional jump which will bring the Community considerably nearer to a political union. How is it possible to envisage this union if the Member States are not in agreement either with its necessity or with the objectives of economic and social policy? This agreement, which is already often expressed within the present framework of the functions of the Community, is founded on the conviction that Member States have a common view of their essential interests and are convinced that, by acting in common, they expand their capabilities with regard to both their own internal development and the duties which fall on them in external affairs.

Thus, a new frontier is taking shape for the Community, which, in any case, needs to have the means for reinforcing its capacity for action and its efficiency in the areas of foreign policy and of security, which is the other essential element for building a European union, and which the Single European Act recalls, in its preamble, constitutes the political objective of the 12 Member States.

To advance harmoniously towards this European union, the Community will have to have an institutional schema which meets the two imperatives of efficiency of action and of democratization of the decision-making process. The preparation of the necessary amendments to the Treaty of Rome is the task of two intergovernmental conferences, one for economic and monetary union and the other for strengthening the political dimension of the Community, including the desired expansion of its powers.

These two courses of action are therefore interconnected and must lead to a common philosophy on the institutional framework. A constant link must therefore be maintained between the two series of negotiations in order to ensure a consensus on the objectives and coherent approaches to debate, democratization, decision-making and the implementation of decisions.

Without doubt, this will be the occasion for a wide-ranging debate, enriched — at least as far as the six founder countries are concerned — by the experience of nearly 40 years

of living together. What can we learn from this short history? That the founding fathers of the Community, with imagination and realism, devised a system which would make possible the gradual integration of our countries in a setting where the workings of the institutions are open, dynamic and, moreover, realistic, since every step forward must be ratified by the sovereign bodies of each country. Given the success already achieved, thanks in particular to the balanced working of the existing institutions, we must take care that, even with the best of intentions, we do not arrive at a system which is bogged down in sterile tensions between Community institutions or in irresolvable conflicts between Community decisions and national wishes, between the European Parliament and national parliaments.

This consideration, which is of prime importance in the eyes of the Commission, has led it to suggest a plan for economic and monetary union which incorporates the basic principles of the Treaty of Rome so that the interest of the Community is constantly promoted by the European Commission, this being one of the roles assigned to that institution, though not its exclusive privilege. Having noted this, the decision-making mechanism is still based on the Council of Ministers, while the desire for democratization leads us to recommend more active participation by the European Parliament. Alongside this institutional triangle the European Council is confirmed in its role as a driving force in the construction of Europe. The Court of Justice is destined to become more and more the court of appeal in disputes over the application of the rules of the Treaty, a sort of embryonic constitutional court.

This is the spirit which has inspired the Commission in outlining the institutional aspects of economic and monetary union, on the understanding that a single monetary policy and a single currency can only be managed by a single body yet to be created. This is the only new institution required by this plan. It has been conceived with two considerations in mind: efficiency and the principle of subsidiarity. It will have the independence necessary to carry out its mandate, the unremitting pursuit of price stability, which is required not only to have a strong currency but also to permit continuous, durable growth creating jobs and prosperity.

The same principles will guide the European Commission when, as for economic and monetary union in the present document, it comes to make its proposals for the second intergovernmental conference, to be devoted in the European Council's own words to 'political union'.

Of course, nothing would have been done, nothing can be done, without a strong political will expressed clearly by the Member States. But it is worth repeating that nothing would have been done or can be done without an institutional system which, while taking account of the legitimate interests arising from the situation of each country, is also able to identify the general European interest and then to firmly promote it.

The new impetus for economic and monetary union started with the Hanover European Council of 1988 deciding to entrust a committee with 'the task of studying and proposing concrete stages leading towards this union'. On the basis of the Delors Committee Report, the Madrid European Council decided one year later that Stage I of economic and monetary union would start on 1 July 1990 and asked for the preparation of the Treaty

changes necessary for Stages II and III. Now, the first stage of economic and monetary union has come into effect as foreseen and the June European Council in Dublin has consolidated the drive in favour of economic and monetary union by noting 'that all the relevant issues are being fully and thoroughly clarified', by deciding that the intergovernmental conference for agreeing on the necessary Treaty changes will open on 13 December 1990, and by stating that further work should be carried out 'in such a way that negotiations on a concrete base can be entered into as soon as the conference opens'.

In recent months the Commission has made contributions to the clarification of the major issues in all bodies concerned with the preparation of the intergovernmental conference. The present communication not only presents a synthesis of the Commission's view but also attempts to build a consensus in bridging, as far as possible, the opinions expressed in these bodies. The UK Government's position has also recently evolved positively by accepting, in its 'hard ecu' proposal, the necessity of a Treaty revision, the creation of a common monetary institution and that the ecu could eventually become the single currency in Europe. In this communication reference is made to the proposal, but it is not seen as fitting easily into the general conception, based on the Delors Committee recommendations, on which widespread agreement has emerged not only between the other Member States, in the Council as well as in the Committee of Central Bank Governors, but also in the European Parliament.

This communication is the contribution of the Commission for a full and adequate preparation of the intergovernmental conference. The Commission is confident that the timetable envisaged by the Dublin European Council of ratification before the end of 1992 can be kept. It is therefore proposed to start Stage II on 1 January 1993. It is essential to make good use of the time until then; indeed, the first stage should make it possible to achieve a high degree of convergence, to reinforce monetary policy coordination and to promote the role of the ecu. The second stage would then become a phase of intensive preparation during which the European System of Central Banks would be set up. While there is already now a clear economic case for a short duration for the transition, the beginning of Stage III and the introduction of the ecu as the single currency would be the subject of political agreement by the European Council.

For the definitive economic and monetary union, the communication advocates a design similar to that of the Delors Committee Report. Economic and monetary union is a whole; the European Council would be concerned with the overall coherence of the Community's economic and monetary policy. The Commission proposes that the Treaty should designate the ecu explicitly as the future single currency of the union. Moreover, a single monetary policy is required which will have to be determined in a centralized way by a new Community institution. The new institution would be independent and democratically accountable; the institution would be committed to the objective of price stability and, subject to the foregoing, should support the general economic policy set at the Community level by the competent bodies.

Economic union would be founded on the internal market, on closer coordination of economic policies and on the development of common policies. This requires a reinforcement of multilateral surveillance. Two rules concerning budget deficits (no monetary financing and no bailing-out) should be introduced into the Treaty. The Treaty should also state the

principle that excessive budget deficits must be avoided. Furthermore, two new economic policy instruments would be created: multiannual guidelines for economic policy to be formally endorsed by the European Council and a specific financial support scheme which would be activated when major economic problems arise or when economic convergence calls for a particular Community effort alongside national adjustment strategies in the sense of positive conditionality.

Common policies would be further developed in the economic union with the aim of improving economic efficiency and fostering economic and social cohesion. For improving economic efficiency a growing Community involvement in policy areas with important European-wide effects should be foreseen and, when necessary, present Treaty provisions be extended or modified. In the final stage of economic and monetary union there might also be the need to further strengthen Community structural policies; their instruments and resources would have to be adapted to the needs of the union. For the structural Funds, consideration should be given to widening the eligibility criteria and to endowing them with a greater capacity to respond more quickly and more flexibly. Furthermore, the new special financial support scheme might be used in favour of the cohesion objective on condition that this fosters economic convergence more generally.

\* \* \*

To put the role of the intergovernmental conference in its proper context, it should be recalled that at the same time the construction of Europe is continuing at a rapid pace, stimulated as it is by the results already achieved in the economic and social spheres, by the implementation of the Single Act and the prospects which it offers, and pushed forward as it is by the demands from the outside world, especially the larger Europe in the process of rapid change.

More than ever since its history began, the Community is under pressure to define the level of its ambitions and to take up the responsibilities which are incumbent on a group of rich countries with their history, culture and material potential.

Without awaiting the outcome of these conferences, the Community must therefore demonstrate its ability to take up these two challenges, internal and external. It must not let itself be diverted by its discussions on the two plans for the future constituted by economic and monetary union and political union. Indeed, it will not be able to put these plans into effect unless at the same time it reinforces the credibility of the objectives of the Single Act and lays the foundations for the new system of international relations in which history has reserved for it, if it has the will and the means, an important role alongside the other great world powers.

Among the objectives which the Community has to achieve, only those which are fully associated with the success of economic and monetary union are mentioned here: the single market by the end of 1992, reinforced cooperation in the fields of research and technology, the environment, infrastructure networks, the social dimension and, even more directly, economic and social cohesion. This last objective, which is written into the Single Act, is at present being pursued by means of structural policies aimed at giving each region a chance with the corresponding responsibility for planning and implementing its own



development. A first balance-sheet of these new policies, decided by the European Council in February 1988, will be drawn up by the Commission at the end of next year. Thus, the European Council will be in a position to assess the appropriateness of the approach, the need for adjustments or additional measures and the means to be allocated to the policies, in terms of both financial and human resources.

During the same period, the European Monetary System will further demonstrate its essential contribution to economic convergence and the pursuit of European monetary stability in a world characterized by unstable foreign exchange markets and sharp fluctuations in the financial sector. Together with the multilateral economic surveillance exercises conducted by the Economic and Finance Ministers and the strengthened role of the Committee of Governors, the EMS will be one of the three pillars of Stage I of economic and monetary union. Once again, therefore, we are reminded of the importance of the Community's day-to-day activities for the achievement of its long-term objectives.

# 1. Benefits and costs of economic and monetary union

The economic impact of economic and monetary union will deeply affect the workings of the Community economy, and will go to the heart of the determinants of both inflation and growth. Moreover, its repercussions will extend as far as influencing the management of the world economy.

The benefits and costs of economic and monetary union are the subject of an extensive analysis currently being completed by the services of the Commission, with contributions from independent experts. This study will be published by the Commission in the near future, thus underpinning the summary presented in the following paragraphs.

While quantification of many partial features of the overall economic impact will be possible, there are fundamental reasons why an aggregate estimate of the impact of economic and monetary union is not feasible (unlike the Cecchini Report on 1992). This is because economic and monetary union will cause a very complex chain of reactions: the systemic changes will lead to policy changes, and both will condition behavioural changes in the economy, before arriving at the final impacts in terms of economic well-being. Much of the impact will therefore be indirect, and conditional on the responses of governments as well as private economic agents.

There will, none the less, be important linkages between the real economic impacts of the completion of the internal market by the end of 1992 and economic and monetary union. A single currency is the natural complement of a single market. The full potential of the latter will not be achieved without the former. Going further, there is a need for economic and monetary union in part to consolidate the potential gains from completing the internal market, without which there could be risks of weakening the present momentum of the 1992 process. Economic and monetary union therefore offers the prospect of consolidating the single market as well as bringing its own value-added to the performance of the Community economy.

## 1.1. Definition

Economic and monetary union is a whole. The definition given here follows the Delors Committee Report on both the monetary and economic sides.

Monetary union is recognized as either irrevocably fixed exchange rates or a single currency; a single monetary policy is the central characteristic of both these regimes. The single currency is clearly the first-best in terms of the economic benefit / cost ratio.

Economic union would see a much lesser centralization of policy competences than monetary union, following the principle of subsidiarity. It would be founded on the internal market and would require the Community to have common economic objectives and a close coordination of economic policies as well as the development of the common policies. Budgetary policies, at national and EC levels, would be affected in important ways as proposed below.

For the purpose of analysing the benefits and costs of the definitive economic and monetary union, as just defined, the point of comparison must be identified. For this purpose, the comparison may be made with a Community that would have completed its 1992 programme for the internal market and retained the European Monetary System (1992 plus EMS). However, this is an abstract point corresponding to stated ambitions. In reality such a point may not exist since, in the absence of expectations of progress to economic and monetary union, 1992 plus EMS might well prove not to be stable. This is because complete capital liberalization and exchange rate stability impose virtual unity of monetary policy. In other words, if the dynamics of economic and monetary integration progress are not recognized, extra costs might have to be borne because of difficulties in sustaining the present system. This means that the benefits of moving to economic and monetary union would effectively be greater.

## 1.2. Major benefits and costs

These may be grouped under the following headings:

(i) *Efficiency and growth.* Elimination of exchange rate variability, uncertainty and transaction costs, and further refinements to the single market are sure to yield gains in efficiency. Through improving the risk-adjusted rate of return on capital (adjusted for exchange rate related risk and uncertainty factors), and the business climate more generally, there are good chances that a credible commitment to achieving economic and monetary union in the not-too-distant future will help further strengthen the trend of investment, growth, and employment.

(ii) *Price stability.* This is an objective *sine qua non* for economic and monetary union. It is also beneficial economically in its own right, for example through allowing the price mechanism to work efficiently for resource allocation purposes. The main problem for policy-makers is that of attaining price stability at the least cost, and then maintaining it. The Community has the opportunity of being able to build its monetary union on the basis of the reputation for monetary stability of its largest national economy, and more recently, increasingly also of other narrow-band participants in the EMS. Given the paramount importance of credibility and expectations in winning the continuous fight against inflation at the least cost, this is a great advantage.

(iii) *Public finance.* A new framework of incentives and constraints will condition national budgetary policies, which will be generally conducive to macroeconomic discipline and stability. Economic and monetary union will bring valuable gains for many countries' national budgets through reductions in interest rates, as inflation and exchange risk premiums are eliminated. These benefits will outweigh the loss of seigniorage revenue to be experienced by some countries.

(iv) *Employment and regional balance.* The improved prospects for growth outlined above will contribute to increased employment. The main potential cost of economic and monetary union is that represented by the loss of the nominal exchange rate as an instrument of economic adjustment. This loss should not be exaggerated for several reasons: exchange rate changes by the Community in relation to the rest of the world will remain possible, whereas within the Community the nominal exchange rate instrument is already largely abandoned; far from freezing relative labour costs and competitiveness, economic and monetary union, in the right policy context, will encourage necessary changes, and policies at national and Community levels will also absorb shocks and aid adjustment. In its present form, the external current account constraint will disappear for individual Member States which will be a great advantage, even if the national performance in trade of goods and services will continue to have some influence. For the EC as a whole the constraint will of course remain.

(v) *The international system.* With the ecu becoming a major international currency, there will be advantages for the Community as banks and enterprises conduct more of their international business in their own currency. Moreover the monetary authorities will be able to economize in external reserves and achieve some international seigniorage gains. Economic and monetary union will also mean that the Community will be better placed, through its unity, to secure its interests in international coordination processes and negotiate for a balanced multipolar system.

### **1.3. Benefits and costs in the processes of convergence and the transition**

Much progress has been made in the Community recently in convergence in terms of inflation, cost trends and sound public finance. Even the presently more divergent economies could plausibly now adapt their medium-term economic strategies to the prospects of full participation in economic and monetary union.

The costs of the transition to economic and monetary union (for example disinflation, and the reduction of budget deficits) for those countries would be greatly reduced by the setting of clear political commitments with fixed dates. If economic agents (public authorities, companies, trade unions, individuals) perceive these commitments to be credible, they will anticipate the effects of economic and monetary union in their economic strategies and behaviour. Such a process has already been at work to advantage with the 1992 programme, and a similar strategy could be equally beneficial for economic and monetary union, if not more so.

Since most of the costs of moving to economic and monetary union arise in the preparatory stages of the economic and monetary union process, whereas some of the important benefits (elimination of exchange rate uncertainty and transaction costs, a better international system) arise only in the definitive regime with a single currency, there is a clear economic case for a short duration for the transitional period.

As regards the regional distribution of the impact, which is relevant to the objective of longer-term convergence of economic performance, there are no a priori grounds for pre-

dicting the overall pattern of relative gains and losses. There are risks and opportunities of different types affecting all categories of regions. However, social and economic cohesion involves the reduction of existing regional disparities as well as ensuring that economic and monetary union does not lead to any increase in disparities. Policy actions already seek to achieve these aims and to reduce locational disadvantages. The performance of structural and regional policies will have to be evaluated and if necessary be adapted and strengthened in the light of experience. However, the key to the catching-up process lies in obtaining synergies between Community policies (for 1992, the structural policies and the move to economic and monetary union) and national efforts to upgrade the least favoured regional economies and to prepare for 1992 by supply-side measures. The fixing of clear policy objectives, such as for the internal market and economic and monetary union, are also highly relevant here for mobilizing such efforts.

#### **1.4. Overall evaluation**

Summarized in terms of the conventional distinction between the three major objectives of economic policy, the likely impact of economic and monetary union is:

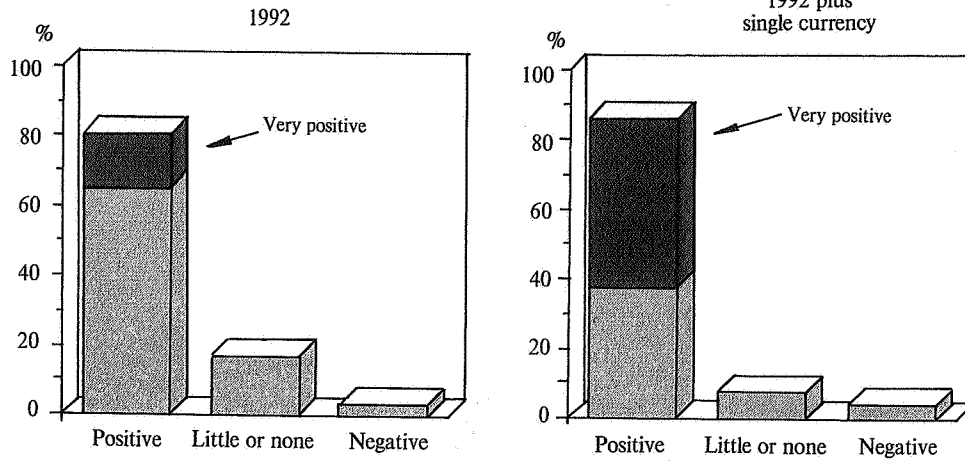
(i) efficiency and growth: sure advantages, as a single currency and economic union complements the single market and adds to its impact. Economic analysis supports the perceptions of industrialists. One market needs one money (see Graph);

(ii) stability: sure advantages as regards better overall price stability (i.e. both very low inflation on average, and low variability) assuming that the design of the system is handled well, and likely gains also in terms of the stability of the real economy (lesser fluctuations in output and employment);

(iii) equity: no a priori balance of relative advantage for any particular type of region. Nevertheless, in the light of experience, structural and regional policies will have to be evaluated and if necessary be adapted and strengthened. However, the currently less well-off regions have a real opportunity for rapid catch-up, if they maximize potential synergies between EC policies (in particular the structural ones) with national development efforts. Economic and monetary union, like 1992, is a positive-sum game.

**GRAPH: A business perception of the microeconomic impact of EMU**

Opinions on the prospects for the business climate become very much more positive when a single currency complements the single market.



Source: Business survey undertaken for the Commission of the European Communities by Ernst & Young.

## 2. Monetary union

### 2.1. The choice of a single currency

Monetary union is fully completed with a single currency. The analysis (see Chapter 1) shows that the advantages expected from a monetary union can only be reaped fully with a single currency.

Adopting a single currency rather than having national currencies with irrevocably fixed exchange rates would not only have a symbolic character. It constitutes a point of no return. Also it totally eliminates transaction costs. The maintenance of several currencies would leave in existence residual transaction costs on small-sized operations, and makes market transparency less than full. The existence of distinct capital markets would not allow the economies of scale associated with monetary union to be exploited completely. Interest rate differentials could subsist in particular between the long-term segments of capital markets. Finally, Europe would not appear as a genuine monetary entity; it would not reap the external benefits linked to the emergence of the ecu as a major currency next to the dollar and the yen.

The completion of the monetary union does not imply, however, the immediate establishment of a single currency, which may require a technical and psychological delay in order to deploy the new payment instruments and prepare the public at large to use them. But the final objective must be clear: Europe needs a single currency. This choice influences the conception of the institution that will be responsible for issuing and managing this currency.

From the beginning of Stage III, the Community institution created during the preceding stage would be solely responsible for defining the Community's monetary policy. This centralization removes a priori any possibility of conflict between different monetary policies within the zone. This institution would also guarantee unlimited convertibility of the different national currencies and the fixity of their parities. These currencies would thus be perfectly substitutable and by definition there would be a single monetary policy.

### 2.2. General principles and organization

The Community's monetary policy and the institution responsible for it need to be committed explicitly to the objective of price stability. Given this priority, they have to support the general economic policy objectives defined at Community level by the competent institutions.

The stability commitment needs to be written in to the basic legislative texts. But in order to be fully credible, the new Community monetary system also needs to enjoy a high

degree of independence *vis-à-vis* national governments and other Community bodies. This independence should concern the system, which would include the existing national central banks, its working conditions and its agents. The appropriate means to meet this requirement are of two types: on the one hand, the freedom not to have to take measures likely to compromise the fundamental stability objective; and, on the other hand, the duration of the mandate as well as the appointment and dismissal conditions with regard to the persons called upon to serve the institution. In addition to Community legislation, national provisions should be adopted to ensure that the central banks enjoy the necessary independence *vis-à-vis* national authorities.

The Community monetary institution needs to be democratically accountable for its actions. This principle is the necessary corollary of its independence, in order to make the policies defined by the institution acceptable to political representatives and to public opinion at large. The democratic legitimacy of this institution would stem from both the legal provision creating it (a treaty submitted to ratification by the national parliaments) and the method of appointment of its president and the board members, which will be designated by the European Council after consultation with the European Parliament.

Reports would be presented periodically to the European Council and the European Parliament. The president of the institution would be responsible for explaining its policies generally and to the Community institutions: the President of the Council and a Member of the Commission would attend meetings of the decision-making body of the monetary institution. The Commission would make observations which, in its view, relate to the consistency between monetary policy and the general economic policies adopted at Community level.

Taking into account the nature of the Community and the long experience of the national central banks, the new monetary institution should have a federal structure and comprise the existing national central banks and a central body. The system as a whole could be called the European System of Central Banks (or, in brief, 'Eurofed'). Eurofed would be placed under the authority of a Council composed of the 12 governors of the Community central banks and of a smaller number of members from the central body, called the board of directors (in brief 'board').

The Eurofed Council would be responsible for determining the Community's monetary policy: it could for example set main rates and define intermediate objectives. The Council would meet periodically and as often as necessary, in order to determine the monetary policy stance. It would decide by simple majority of its members' votes (one man, one vote).

The board would be responsible for the day-to-day conduct of monetary policy on the basis of the instructions given by the Council. It would manage the central body which would have the necessary capital and sufficient staff to analyse all aspects of the common monetary policy and follow monetary trends. The members of the board would be appointed because of their professional competence. Their mandate should be of long duration and irrevocable. The president would be a member of the board: he would represent Eurofed.



This set of provisions will ensure to Eurofed the necessary credibility for the effectiveness of its action.

### **2.3. Internal monetary policy and the ecu**

For the conduct of the Community monetary policy Eurofed will be endowed with the means and powers necessary to use the whole range of monetary policy instruments including open-market operations, repurchase operations, intervention rates, reserve requirements, etc. The regulation of the monetary conditions will be made by recourse to market-oriented instruments, mainly open-market operations.

The ongoing process of European financial integration reinforces the trend towards homogeneous financial structures and more uniform methods of monetary regulation. Monetary union eliminates the borders between the national monetary areas: financial instruments of the same nature with identical risks will become perfectly substitutable and provide a unified market where there will only remain one interest rate. In this context any intermediate objective of the Eurofed can only be defined on a Community basis.

The policy defined by the Council of Eurofed will be carried out by the national central banks as executive agents under the authority of the board of directors of Eurofed. With the adoption of instruments compatible with indirect monetary regulation (as defined above), the risk of endangering the coherence of monetary policy will be eliminated. Their instruments will be compatible, even if, at least initially, they still reflect certain specific national characteristics. In other words, a single currency regime will allow a certain differentiation in the technical modalities of how to implement the monetary policy defined at Community level, it being understood that the national central banks will no longer have any room for manoeuvre in fixing the interest rate applicable to the zone in its entirety.

The final responsibility for the payment system will be with the Council of Eurofed. But, in accordance with the principle of subsidiarity, the national central banks will be responsible for the proper functioning of the national payment systems, the links with national financial institutions and the business communities, the surveillance of the market, etc.

The irrevocable fixing of exchange rates will deprive the basket formula for the ecu of all significance. As a genuine currency the ecu would become the reference unit for non-Community currencies. The continued existence of national currencies in the Community will at this stage have mainly a symbolic significance; it will be technically justified during the period necessary for putting the Community money (coins and bank notes in ecus) into circulation and for linking the payment systems.

But the introduction of a single currency characterizes the full monetary union: the ecu will be that single currency. It will have the full status of a genuine currency and be a symbol of the unity of the monetary area: it will be issued solely on the authority of Eurofed, circulating as the denominator of economic and financial transactions in the area and will be legal tender. At the changeover to the ecu as a single currency, all credits and debts previously denominated in national currency will have to be converted into this new unit.

This conversion can take place smoothly given that the interest rates attached to the different currencies will have been equalized at the time of the fixing of the parities.

## **2.4. The ecu and external monetary policy**

The ecu will also have an important role to play in the international monetary system. For the Community the development of the ecu as a major world currency will involve an increasing use of the ecu in international transactions, the possibility of benefiting from the seigniorage accruing to the issuer of an externally held currency, portfolio shifts in favour of ecu-denominated assets as a result of a diversification process, and finally the possibility to hold a smaller amount of foreign exchange reserves.

Economic and monetary union will give the Community an appropriate role in the design and management of a more stable and responsible international monetary system. For this the Community should be represented on the international scene in an analogous way to individual countries, i.e. by those responsible for economic policy, assisted by the monetary authority — Eurofed.

Because the exchange rate is an important element of external economic policy, external monetary relations have a double aspect, monetary in a narrow sense and economic. They therefore require the participation of two actors, the monetary authority and the body responsible for economic policy. Existing models vary from one country to another. The German or US examples show a different sharing of responsibility in the definition of an exchange rate and intervention policy. In the USA the executive is in charge; the German model gives more weight to the central bank. The discussions have revealed some differences of opinion on this point. While there is unanimous agreement that the choice of the exchange rate regime and the negotiation of international monetary agreements should continue to be a matter for the political authorities, assisted by Eurofed, there is some disagreement about the allocation of responsibilities for exchange rate and intervention policy.

However, it is important that the exchange rate policy should be defined in a framework of close cooperation and that it should follow some basic principles: especially that foreign exchange interventions *vis-à-vis* third currencies should not be in contradiction with the principal objective of monetary policy, i.e. price stability. Interventions in the markets for foreign exchange and the daily management of foreign exchange reserves could be conducted on the basis of instructions from the board of Eurofed. The board should be able to decide to use the reserves put at its disposal for its own interventions or to request the intermediation of a central bank.

## 3. Economic union

### 3.1. Principles, objectives and coherence

There does not need to be a single economic policy in the same way as for monetary policy, and correspondingly there is not the same need for institutional change. Even in mature federations economic policy is made up of different functions and is conducted at different levels of government. In such federations, the principle of subsidiarity is an important criterion for assigning functions to the different levels of governments implying that it has not only a theoretical but also a solid empirical foundation.

The Community's involvement in economic decision-making should be based on a balance between subsidiarity and parallelism. Most economic policy functions will remain the preserve of Member States even in the final stage of economic and monetary union.

None the less there should be agreement at the Community level on the principal objectives of economic policy as they feature already in the Treaty: a harmonious development of economic activities, a continuous and balanced expansion, an increase in stability, an accelerated raising of the standards of living, and economic and social cohesion. These objectives should be pursued within the framework of flexible market-oriented economies and of price stability. The latter, of course, is the main objective of monetary policy.

Member States and the Community should be committed to conduct their economic policies in such a way as to attain these objectives. The Community's potential contribution to their attainment will be discussed under the headings of efficiency, cooperation and economic and social cohesion.

The sound functioning of economic and monetary union will require coherence between these three aspects (efficiency, cooperation and cohesion) of economic union as well as coherence between the monetary and economic aspects of the union. Coherence within the economic union requires a decision-making capacity such that the determination of policy at Community level avoids inefficient overlapping and contradictions in the various aspects of economic policy. The European Council should ensure coherence, and more operational cooperation should be established between the Ecofin Council, the Commission and the European Parliament. The Economic and Social Committee should be consulted on matters of its competence.

For the Ecofin Council to make economic policy effectively does not warrant major changes in institutional powers. The Council has the capacity to act in the legislative and budgetary domains, as well as assure coordination. With the increased responsibilities of the economic and monetary union, these functions may be expected to develop strongly, but within the existing institutional framework.

For the consistency between the economic and monetary aspects the Commission will have the responsibility to make observations, and there will be cross-participation of the representatives of the decision-making bodies (see Section 5 below on institutional aspects). A particular responsibility of the Ecofin Council will be to define in cooperation with Eurofed the Community's external economic and monetary policy.

### **3.2. Efficiency**

The main pillar of economic union is the completed internal market within which persons, goods, services and capital move freely. In order to exploit fully the potential of the internal market, the Community should deepen the drive to improve resource allocation and competitiveness, and stimulate innovation through research and technology and entrepreneurship. To this end the Community's involvement in policy areas with important European-wide effects should grow. These concern in particular competition policy, commercial policy, research and technological development, European-wide infrastructure, labour markets, the environment, and some aspects of taxation.

Competition policy and commercial policy have already an important place in the Treaties, but their importance will increase with the completion of the internal market, the realization of economic and monetary union and the increasing cooperation with other European countries including those of Central and Eastern Europe.

The Treaty also provides a legal base for some Community involvement in research and development, European-wide infrastructure, labour markets, the environment and taxation. Policy advances can, to some extent, be obtained on the basis of the present Treaty provisions. However, judging from experience there is the risk that the existing base would not lead to desired progress. In the Commission's view it would be against the principle of parallelism if major progress in the monetary field would not go hand in hand with considerably strengthened Community policies in these fields which are crucial for the overall economic efficiency of the European economy. It might therefore be necessary to extend or modify the present Treaty provisions for at least some of these policy areas.

The decision-making rule of unanimity could prove to be a major obstacle for sufficient progress in the fields of the research and technological development, the environment and aspects of taxation for all of which a strong economic case can be made for a more substantial Community involvement.

Research and technological development has an important role to play for increasing the competitiveness of European industry. The Community's growing involvement should reduce the fragmentation of national efforts, increase the coherence in long-term strategic objectives and exploit economies of scale. Community environmental policy becomes more important in the context of the internal market for two reasons. First, it can be misused by Member States as an instrument to create a new segmentation of markets in Europe. Secondly, allocative efficiency in economic terms becomes more and more interrelated with ecological efficiency.

In the field of taxation the necessary harmonization for the completion of the internal market has so far progressed slowly and has given rise to considerable difficulties. In economic union, competitive pressures with regard to taxes on mobile factors will intensify. In order to cope with these pressures, Community involvement might need to be stepped up, since otherwise revenues from such taxes might be considerably eroded.

The Community should also have the responsibility, through a combination of coordination efforts and its own interventions, to see that the internal market enjoys European-wide infrastructures that reach the highest standards attained within Member States. The creation of specific Treaty provisions providing a unified legal base for Community action in particular with respect to highways and railways, telecommunications and energy distribution networks could greatly facilitate real progress in this area allowing a cheaper and faster circulation of goods, services and information. This is also highly relevant for the objective of cohesion.

Labour markets will have to be adapted further. The essential responsibility for wage determination will remain with the social partners. The Community should have some role in encouraging the adoption by labour markets of the best observed practices for labour market management. This concerns especially mobility, permanent education, training systems, the introduction of new technologies and efficient methods of collective bargaining. The Community should also seek to give concrete substance to the Social Charter while enhancing the capacity of national labour markets to adjust to competitive pressures in an efficient way.

### **3.3. Cooperation**

Cooperation between Member States and the Community covering all aspects of economic policy is an essential feature of economic union. This has already been recognized in the Council Decision 90/141/EEC on 'the attainment of progressive convergence of economic policies and performance during Stage I of economic and monetary union' where it has been agreed that multilateral surveillance will cover all aspects of economic policy.

Taking account of the learning by doing foreseen in the Council Decision, cooperation should be further strengthened in the final stage of economic and monetary union. For this purpose, the following specific cooperation instruments are proposed:

- (i) pluriannual economic policy guidelines;
- (ii) reinforced multilateral surveillance of economic policy, including rules for budget deficits;
- (iii) a special financial support scheme.

The pluriannual economic policy guidelines would be drafted each year by the Commission on the basis of a global evaluation of the economic development of the Community and of every Member State. They would set general economic targets for the Community

and identify the means to realize them. For enhancing the compatibility of Member States' economic policies, specific reference would be made to public finance policies, labour market developments, and national structural policies. The guidelines would be submitted to the Ecofin Council and endorsed by the European Council, which would also be concerned with the overall coherence of the Community's economic and monetary policy.

Within the framework of the pluriannual guidelines, multilateral surveillance would be reinforced in the light of the experience acquired during Stage I. In the Treaty a new legal basis for this coordination instrument should be provided for, amending the present Article 103. This should allow the contents of and procedures for multilateral surveillance to be redefined by secondary legislation.

Multilateral surveillance should be open-ended in its coverage of all aspects of economic policy and performance that significantly affect Community objectives. The surveillance would include analyses of supply and demand trends, price and cost developments, competitiveness, employment, regional development, public finance, financial markets and the underlying economic policy orientations. Multilateral surveillance would monitor the economic conditions, prospects and policies in the Member States. Periodically, a global assessment of Member States' economic performance would be made. This would include a review of budgetary policies including an evaluation whether a deficit is excessively high.

If the global assessment is not satisfactory, a gradual system of incentives for policy adaptation would come into play. In normal circumstances, the quality and efficiency of the analysis would provide a basis for change. This could be complemented with an attempt to reach agreement in the context of confidential peer-group pressure. Beyond that, formal recommendations would be made which could lead to public declarations. In addition, the special financial support scheme (further outlined below) could play a significant role, relying on positive conditionality, in bringing about policy adjustments since it would help the Member State to overcome particular economic difficulties.

The threat to monetary stability and the sustainability of the union represented by excessively high levels of deficits and debt and the method of deficit financing (i.e. pressure for monetary accommodation, or instability of the financial system) is a matter of special concern. While other matters of common interest such as normal macroeconomic policy interactions can be adequately covered within the multilateral surveillance process, the potential threat of budget deficits and their financing to monetary stability requires additional provisions. It is therefore proposed that two rules should feature in the Treaty:

- (a) no monetary financing of public deficits or market privileges for the public authorities concerning the placing of public debt;
- (b) no bailing-out; in the case of imbalances, a Member State could not benefit from an unconditional guarantee concerning its public debt either from the Community or from another Member State.

With respect to the method of financing, Member States' external borrowing in non-EC currencies should also be a matter of Community concern given its potential impact on

the monetary policy of the Community. While external financing should not be forbidden, Eurofed and the Commission would closely monitor its development and the Council would be empowered to recommend policy changes in the framework of multilateral surveillance.

In addition, excessive budget deficits may endanger the stability-oriented monetary policy. As a matter of principle, excessive budget deficits therefore must be avoided and this should be stated in the Treaty. In practice, the judgment whether a deficit is excessive is related to the sustainability of the fiscal position, which cannot be evaluated in isolation from an overall assessment of the economic situation and development, and should therefore be an integral part of multilateral surveillance. Nevertheless, some yardstick would seem necessary for the identification of excessive deficits. Despite its definitional shortcomings, the golden rule of public finance, i.e. that public borrowing shall not exceed investment expenditure, appears the most satisfactory from an analytical point of view and is the only one widely applied in existing federations. Complementary to this rule, other objective criteria, such as the deficit and debt to GDP ratios might prove helpful in this context. These rules and criteria will have to be laid down in the Council regulation covering multilateral surveillance.

A special financial support scheme would be provided for in the Treaty, amending the present Article 108. The scheme would be activated when major economic problems arise in one or several Member States or when economic convergence calls for a particular Community effort alongside national adjustment strategies in the sense of positive conditionality. The initiative for activating the scheme could come from the Member State concerned as well as from the Commission. The Council would decide the conditions and details of the support when a case arises, including the need for coherence with multilateral surveillance concerning budget deficits. The support could be given through grants from the Community budget or through loans from a Community financial instrument.

### **3.4. Economic and social cohesion**

It is essential to ensure that the beneficial effects of economic and monetary union are felt in all parts of the Community and thus contribute to cohesion. Unduly large regional imbalances would pose an economic as well as a political threat to the union. For this reason particular attention has to be paid to an effective Community policy aimed at narrowing regional and structural disparities and promoting a balanced development throughout the Community. The Community's existing instruments are already making a substantial contribution to the cohesion objective, as is the greater economic activity associated with the Single Act and the completion of the internal market. Pluriannual programmes for the development of backward regions and of those requiring reconversion have been established by these regions and cover many aspects that are necessary for the adaptation and development of their economies. Concrete experience of this new approach, which was adopted by the Council in February 1988, has now begun. At the end of 1991 the Commission will make a full assessment of the structural policies, and make recommendations on their continuation and further improvement.

The effects of economic and monetary integration may be at least as beneficial for the less-developed regions as for the more prosperous. A greater amount of inward investment may, for example, be attracted by their comparative advantages. The trend towards service industries and high-value manufactured products is already reducing the importance of transport costs in location decisions. However, some historical experience suggests that regions within an economic and monetary union can be disadvantaged over long periods of time unless sufficient measures are taken.

In the final stage of EMU there might be a need to further strengthen Community structural policies. Instruments and resources would be adapted to the needs of the union. In addition, considerations of absorptive capacity, as well as more general considerations, may point in favour of widening eligibility criteria, such as for education, for support to the least favoured Member States.

While adjustment in the Community exchange rate can absorb external shocks to some extent, the exchange rate can no longer be used by individual Member States as a policy instrument to deal with a loss of competitiveness or to adjust to adverse economic shocks. The adjustment must therefore take place in a different form, for example through labour market flexibility and policy measures. The structural Funds could also be endowed with a greater capacity to respond more quickly and more flexibly. Furthermore in such circumstances a conditional Community support as outlined above in the section on cooperation could be activated.

### **3.5. Consequences for Community finance**

Community finance should reflect and support the gradually increasing Community contribution to the attainment of the principal economic policy objectives related to efficiency, cooperation and economic and social cohesion. Such a gradual increase would not imply a large-scale transfer of major expenditure responsibilities from the national to the Community level but would nevertheless require a significant development of Community financial activity in the form of expenditure from the Community budget and of loans from Community financial instruments. As a consequence, the Community's own-resources system and the budgetary responsibilities of the Community institutions will have to be adapted to the needs of the economic union.

The development of Community financial activity would have two dimensions: an extension of the volume of budgetary expenditure and of loans and a more flexible use of the financial means. The extension would reflect the growing Community involvement in areas with important European-wide effects related to internal as well as external policy requirements. The greater flexibility is necessary in view of the growing concern about economic convergence, including economic and social cohesion, which might be threatened by unforeseen economic shocks.

Greater Community responsibility on the expenditure side would have to go hand in hand with an increased capacity on the revenue side of the Community budget. Moreover, the Community's loan instruments would have to adjust their activities to the needs of the



economic union implying in particular a closer and more effective combination with budgetary expenditure. The role and intervention modalities of the EIB will also have to be examined in this context. Moreover, the need for greater flexibility on the expenditure side of the budget would have to have its counterpart on the revenue side involving an adaptation of the present own-resources system.

Greater flexibility of Community finance would require more discretionary powers of the Community institutions, in particular as regards the revenue side of the budget. More generally, the budgetary procedure should be reviewed in order to achieve a better balance of responsibilities between the European Parliament, the Council and the Commission; a balance which should more explicitly recognize the Commission's role already manifest in the 1982 and 1988 agreements. A substitute for the present balance-of-payments loans facility should be devised and its funding extended to budgetary means.

Within the framework of multilateral surveillance the contribution of the Community budget and its borrowing and lending activities to the policy objectives and to economic policy-making should be assessed and consideration be given to improve their cost/benefit ratio in the various functions affecting economic performance and competitiveness.

## 4. Transition

### 4.1. The general conception

The transition is referred to as the time-span between now and the beginning of the third stage of economic and monetary union; four main elements can be considered as essential:

- (i) the transition should be short for the reasons outlined below;
- (ii) Community achievements, notably concerning economic convergence, economic and monetary policy coordination and the consolidation of the EMS, should be reinforced;
- (iii) Eurofed should be created as a new Community institution;
- (iv) the use of the ecu should be stepped up and its development further encouraged.

In fact, the process leading to the achievement of economic and monetary union has already been embarked upon. The first stage started officially on 1 July 1990. Concerning the necessary Treaty amendments for Stages II and III, the Dublin European Council of 25 and 26 June 1990 stated that the intergovernmental conference 'should conclude its work rapidly with the objective of ratification of the results by Member States before the end of 1992'. This strong impulse reflects an increasing convergence of viewpoints on the possibility and necessity for a rapid transition towards a complete monetary union. Indeed:

- (a) in the field of convergence, faster progress than expected can be observed, certainly for the countries participating in the exchange rate mechanism;
- (b) current developments are buoyant. The dynamics of the completion of the single market should be 'capitalized', and the political zest and expectations due to the events in Eastern Europe, in particular German monetary unification, should be profited from;
- (c) the period ahead contains risks of instability due to the gap between the achievement of financial integration, which facilitates currency substitution and financial mobility, and the completion of monetary union. Furthermore, as convergence increases, other currencies join the German mark in its role as anchor of the system. This calls for a multilateral approach to monetary regulation;
- (d) finally, the analysis of costs and benefits of economic and monetary union shows more clearly the gains of the union and especially of the adoption of a single currency. In most important respects, the Community already shows a homogeneity comparable to existing monetary unions, the dynamics of the single market will bring it even closer to being an optimum currency area.

For these reasons, the Commission proposes that the transition should proceed as follows:

(i) Stage I is important; it should make it possible to achieve a high degree of convergence, to reinforce monetary policy coordination and to promote the role of the ecu;

(ii) Stage II would be a phase of intensive preparation, both technically and legally, especially of the monetary union. During this phase, Eurofed would be set up; the secondary legislation emanating from the Treaty would be adopted. This stage should start on 1 January 1993, i.e. at the same time as the completion of the internal market and immediately after the ratification of the Treaty revisions;

(iii) from the start of Stage III, Eurofed would be entirely responsible for the single monetary policy, and the provisions flowing from the Treaty revision would be applied. The timing of the beginning of Stage III and the introduction of a single currency, desirable as soon as possible, would be the subject of political agreement by the European Council based on an assessment of the results achieved during the transition in terms of market integration, convergence, including economic and social cohesion, and economic policy coordination;

(iv) with regard to the participation of some Member States there might be a need for safeguard clauses during the transition. Moreover, there could be a degree of flexibility concerning the date on which some Member States would join in all arrangements of Stage III, this flexibility should be expressed in terms of specific transitory provisions within Stage III. Member States making use of this flexibility could have representatives in Eurofed without them having the right of vote.

The UK Government has recently put forward its ideas on the transition. According to this proposal a 'hard ecu' would be issued in parallel to the national currencies by a 'European Monetary Fund' created to this end. Representing a positive development of the previous proposal of the British Treasury ('An evolutionary approach to EMU'), it favours a new Treaty, the creation of a common monetary institution, and of exchange-rate policy coordination *vis-à-vis* third currencies; it also accepts that the ecu could eventually become the single currency in Europe. This is therefore an important commitment to the creation of an economic and monetary union in Europe and it should be welcomed as a political confirmation of the Madrid and Dublin Summits.

Nevertheless, the proposal does not fit easily into the conception of the transition outlined above. In fact, the complexity of its implementation and its uncertain success would make it hardly suited for an advantageous rapid transition. In addition, the proposal would not help to reduce the existing differences between national monetary concepts and instruments and does not build on the existing multilateral cooperation between central banks. The technical aspects related to the ecu are discussed below in Section 4.5.

## 4.2. What is at stake in Stage I?

### *(a) The completion of the internal market*

The completion of the internal market by the end of 1992 will mean the elimination of all physical, technical, fiscal and financial frontiers in the Community. Two-thirds of the necessary measures have already been adopted; in particular, the free movement of capital is a reality for eight of the 12 Member States, in accordance with the timetable originally foreseen. The advantages expected from the 1992 deadline, in terms of increased efficiency in the allocation of capital, reduced costs arising from intensified competition and faster growth, are likely to influence the expectations and behaviour of private and public economic operators and have certainly played a part in the recent improvement of the Community's economic situation.

### *(b) Intensified economic convergence*

The process of convergence has already made advances in recent years and further progress can be expected as a result of the new arrangements decided by the Council in March (Decision 90/141/EEC):

(i) multilateral surveillance has been established, covering all aspects of economic policy in both the short- and medium-term perspectives. In the context of surveillance, special attention will be given to the evolution of employment, prices and costs, competitiveness, wage-fixing processes and budgets. Member States must also demonstrate that their policies remain coherent with the implementation of the Single Act and that they are making proper use of the structural Funds. The effectiveness of multilateral surveillance relies mainly on the exercise of 'peer pressure' and on the degree of transparency achieved. There must be a passage from the implicit to the explicit, which will have far-reaching economic and political consequences;

(ii) this decision also opens up the possibility of specifically monitoring the development of budgetary policies. Thus, countries where convergence is jeopardized would be encouraged to present medium-term strategies (including for their budgets) for reducing their disequilibria to levels compatible with participation in the subsequent stages of the process of union. These strategies should include the evolution of revenue and expenditure, deficits and the outstanding public debt which would be discussed and, if necessary, amended, during the second half of 1991. Thereafter, Member States should inform the Community about the measures they intend to take.

Moreover, recent advances with respect to the objective of economic and social cohesion should continue; the increasing assistance of Community structural policies should provide an efficient underpinning for the necessary further progress. Their assessment at the end of 1991 provides the opportunity to take stock of the degree to which disparities between the various regions and the backwardness of the least-favoured regions have been reduced.

*(c) Coordination of monetary policy*

Monetary policies must be more closely coordinated during Stage I. The completion of financial integration (especially the liberation of capital movements) and the objective of exchange-rate stability in the EMS reduce the real autonomy of national monetary policies and call for common responses to externally generated shocks (in particular fluctuations in non-EMS currencies). The Committee of Governors must already prefigure the future Community monetary institution which will be set up at the beginning of the second stage. The existing institutional framework offers the necessary margins of manoeuvre for the development of coordination and makes it possible to begin the learning phase of the common monetary policy.

A decisive step forward in cooperation between the central banks will be accomplished with the introduction of explicit *ex-ante* coordination of monetary policies, accompanied by regular *ex-post* monitoring exercises. During this first stage, the technical aspects of such an exercise are, doubtless, less important than the procedure itself. Indeed, the Member States will continue to take a variety of objectives as reference points (monetary aggregates, domestic credit, exchange rates, etc.) and one task of the Committee of Governors, now with permanent structures, will be precisely to reduce the differences between the various concepts and instruments. Nevertheless, the simultaneous announcement of their objectives by the national central banks will be a tangible sign of the beginnings of a Community policy in the eyes of the public and the markets.

*(d) Evaluation of the results of Stage I*

At the end of Stage I, i.e. at the end of 1992, the Commission would submit a report to the European Council on the progress on economic and monetary union. The report would contain an in-depth economic evaluation of the results of the first stage in terms of deepened integration in goods, services, capital and labour markets; intensified economic convergence; strengthened economic and social cohesion; and improved policy coordination. In addition, recommendations would be put forward in the report for overcoming difficulties that might have occurred during the first stage. The aim should be to enable all Member States to participate in a rapid transition to the definitive economic and monetary union.

### **4.3. Consolidation of the EMS**

The EMS should be further consolidated. As far as the exchange rate mechanism is concerned, the Basel/Nyborg agreements of September 1987 have shown the way by widening the possibilities for the central banks to make use of very short-term financing and by strengthening the role of the ecu in the Community's support mechanisms. There is a steadily increasing tendency for central banks to concert their interventions in the foreign exchange markets.

During the first stage, all the Community currencies should be brought into the narrow band of the exchange rate mechanism. Thus, Spain could quickly give up its 6% margin

as Italy did last January. For its part, the British Government recently let it be understood publicly that an early entry of the pound sterling into the ERM was likely. The entry of Portugal and Greece into the mechanism will depend on the degree of convergence which they achieve. Rigorous economic policy programmes, supported by the large transfers of resources from which these countries benefit, could lead to entry before the second stage.

The enlargement of the exchange rate mechanism is essential for the creation of uniform monetary conditions throughout the area and for its credibility with respect to non-EMS currencies. Thus, the ecu, in whose composition the pound sterling accounts for 13% of the total, would gain in terms of stability and would be given further impetus.

#### **4.4. The creation of the new monetary institution**

The main characteristic of Stage II will be the establishment of a new Community monetary institution, called the European System of Central Banks (ESCB), or Eurofed. In the UK paper it is also proposed to set up a new monetary institution called the European Monetary Fund (EMF).

During the second stage the national central banks will retain the ultimate responsibility for the conduct of monetary policy. This does not imply the creation of an 'empty shell'. This will be a period of intensive learning during which the central body of Eurofed must participate actively in the management of the EMS and of foreign exchange reserves as well as having a pivotal role to play in the coordination of the activities of the central banks; it should also take over the task of the European Monetary Cooperation Fund. Eurofed should increasingly play an active part in the coordination of monetary policy including the determination of interest rates and the definition of monetary objectives. The statistical, operational, regulatory and logistical instruments to conduct a single monetary policy will be set up and tested. It would also be in charge for making the necessary preparations for the ecu to become the single currency.

There is no contradiction between Eurofed's role in the second stage and its legal status. On the one hand, it is clear that a purely legal conception of monetary sovereignty, already very much a formal matter in the EMS, will no longer have much significance when the Member States are on the verge of entering fully into the monetary union. On the other hand, it should be said that internal conflicts in the Eurofed are likely to be the exception in a context where the objectives will be fixed by agreement and where the central body will exert collective pressure to correct deviations from guidelines voluntarily agreed to at the outset.

#### **4.5. The ecu**

As has been argued above, a single currency is an essential feature of economic and monetary union. In the same way as it is not acceptable that the single monetary policy should be determined by one of the existing national central banks, it is not desirable that the single currency should be one of the existing national currencies. Furthermore it should not be a new 13th currency. For these reasons and because public acceptance should be impro-

ved, introducing a new monetary denomination, however, requires time and management. Existing arrangements for the ecu should therefore be built upon as much as possible.

The ecu is already to some extent the common currency of Europe. It is a basket of the various national currencies. But it is also destined to become Europe's single currency. With this in mind, it is necessary to consider how its use can be increased during the transition and to define clearly its position in relation to national currencies and to encourage its development.

The expansion of the role of the ecu in commercial transactions and in the markets requires a strong impetus from the national and Community public authorities. This impetus could take several forms:

- (a) the removal of all legal and regulatory obstacles to its private use; in particular, economic agents must be allowed to freely make legally binding contracts in ecus;
- (b) the generalization of the use of the ecu in the operation of the Community institutions, including for the own-resources system of the Community budget;
- (c) the extension of the use of the ecu in operations between the Community central banks, and in their interventions in the foreign exchange;
- (d) the development of the use of the ecu in the issuing of public bonds and in public borrowing operations;
- (e) encouraging the smooth development of the ecu market by central banks and Eurofed.

However, all these efforts will only be fully validated by the clear provision in the Treaty that designates the ecu explicitly as the future single currency of the union. This would reinforce its credibility and act as a powerful stimulus to its use.

In any case, there would be no discontinuity between the present ecu and the single currency of the union; ecu obligations would be payable at face value in ecus. During the transition the ecu would be increasingly used, but in the same way as it is now alongside the national currencies. It would not, however, formally abandon its definition as a basket until the moment of the irrevocable fixing of parities.

From the monetary point of view, the implications are clear: the ecu will continue to be defined by its component currencies until Stage III and the national central banks will retain in the last resort their monopoly over the issuing of money in the area. But during the transition, as realignments become very infrequent and as all currencies fully participate in the exchange-rate system, this basket definition will have increasingly less practical relevance. If all the currencies perform well, the average is as good as the best, and the ecu becomes *de facto* a 'hard ecu'. This is already more and more the case.

There are disadvantages in prematurely abandoning the basket definition of the ecu. The introduction of a 13th currency in the Community, as put forward notably in the UK pro-

posal and even with the precautions taken there to avoid extra money creation, would increase the risks of instability in a period (the completion of the internal market) when it is important to limit the effects of competition between currencies. Furthermore, a parallel currency would not be consistent with the accepted strategy of strengthening the coordination of monetary policies, albeit on a voluntary basis.

Concluding, the ecu should become an increasingly 'hard' currency during the transition.



## 5. Institutional aspects

The creation of the economic and monetary union based on the design outlined above necessitates several important Treaty modifications. In particular it will be necessary to agree upon the objectives of economic and monetary union; to define the characteristics of Eurofed, the new Community institution for which the committee of central bank governors is already drafting a statute proposal; to adapt the economic role of the existing Community institutions; to mention the principal provisions for the transition; to attempt to find a satisfactory balance between the institutions and to clarify their role.<sup>1</sup>

### 5.1. The creation of Eurofed

(a) The Treaty would state three fundamental principles for the institution:

(i) the objective: price stability. Subject to this objective, Eurofed should support the general economic policy set at the Community level by the competent bodies;

(ii) independence of Eurofed from national governments and Community authorities;

(iii) democratic accountability.

(b) The Treaty should also define the tasks of Eurofed. The major ones would be the following:

(i) the formulation and implementation of the single monetary policy and the issue of ecus;

(ii) exchange rate and reserve management in accordance with the guidelines defined by the Council of Ministers; participation in international monetary cooperation;

(iii) participation in the coordination of banking supervision policies and guaranteeing the proper functioning of the payment system and of capital markets.

(c) The main provisions for the organization of Eurofed would also be included: controlling authorities (council, board, president); relations between the Eurofed Council and national central banks; relations within the system of Eurofed between its central body and the other Community institutions; management and ownership of exchange reserves.

(d) Finally, the Treaty could also deal with the instruments of the common monetary policy as well as other questions concerning the organization of Eurofed (balance sheet,

---

(1) The possible results of the second intergovernmental conference on political union are not taken into account here.

status of the personnel, auditing, etc.). Preferably, the main elements should be defined in the statutes of Eurofed which would be annexed to the Treaty and the other elements should be defined by secondary legislation.

Member States will have to adjust their national legislation on the national central banks in order to ensure conformity with the new Treaty.

## **5.2. Economic provisions**

In the economic field, an institutional framework has already been established under the Treaty of Rome. While on the monetary side a new institution has to be set up, it will not be necessary, on the economic side, to add another institution to the existing ones (European Parliament, European Council, Council of Ministers and Commission), but the roles of the existing institutions should be enhanced and adjusted in accordance with the new tasks which they will have to accomplish in an economic and monetary union.

Similarly, the Treaty provides a definition of the objectives which the Member States and the Community should commit themselves to attain: a harmonious development of economic activities, a continuous and balanced expansion, an increase in stability, an accelerated raising of the standard of living, and economic and social cohesion.

The reinforcement of multilateral surveillance makes necessary the modification of certain Treaty provisions and even more so of the secondary legislation. Two rules concerning budget deficits (no monetary financing and no bailing out) should also be included in the Treaty. The Treaty should also state the principle that excessive budget deficits have to be avoided.

Furthermore, the Treaty would need to provide a legal base for the creation of two new economic policy instruments: multiannual guidelines and the conditional Community financial support scheme; these would also be further specified by secondary legislation.

## **5.3. Provisions for the transition**

The Treaty should specify the procedures for the passage from one stage to another. It should fix the date for the start of the second stage as well as the procedures for determining the beginning of Stage III and for the introduction of the ecu as the single currency.

The Treaty would also provide safeguard clauses for the transition and the possibility of flexibility for some Member States with regard to the date of their full participation in Stage III.

## **5.4. Balance between the institutions**

A satisfactory balance between the institutions of economic and monetary union will have to be found. The creation of a new Community institution in the monetary field,

Eurofed, raises the question of the balance to be achieved between this new institution and the existing ones which will be responsible for the implementation of the economic union.

The Council and the Commission would also have to cope with an increase in their respective tasks: the definition of guidelines for economic policy, participation in negotiations and agreements on international monetary matters, dialogue with Eurofed (particularly with regard to the exchange rate policy), regular multilateral surveillance exercises.

The European Parliament will have to play an increasingly more important role in terms of its democratic responsibilities. In the context of the economic union the reinforcement of the involvement of the European Parliament appears easier to realize in view of the nature of the measures in question, in the form of the control of the executive; it being understood that in addition it should participate in all debates of an economic nature.

The arrangement of Community procedures for the definition of multiannual guidelines and the multilateral surveillance exercise has important political consequences. In their deliberations, the national parliaments will have to take into consideration the guidelines and recommendations flowing from the new procedures. Member States will have to justify their attitudes not only *vis-à-vis* the Community institutions but also *vis-à-vis* domestic public opinion. Consequently, there is a need for these procedures to be highly transparent: sufficient publicity has in particular to be assured for the recommendations which the Community would address to Member States which deviate from jointly agreed guidelines. This necessary transparency of Community procedures is an additional reason for ensuring a balance between the institutions.

## 5.5. The role of each institution

The organization of a satisfactory balance between the institutions, which should form part of the Treaty, should be based on a reinforcement of the role of each, on a certain degree of specialization, and on a precise definition of their relationships having regard to the attainment of the objectives of economic and monetary union:

(a) the European Council would be concerned with the overall coherence of the Community's economic and monetary policy; it would formally endorse the multiannual economic guidelines and would nominate the President of Eurofed and the other members of the Board; the Presidents of the Ecofin Council and of Eurofed would report to the European Council at least once a year;

(b) the Ecofin Council would be responsible, in addition to its present activities, for deepened multilateral surveillance exercises, the issuing of recommendations, the granting of special financial support and for the major decisions concerning the exchange-rate policy (international agreements); it would take its decisions by qualified majority on a proposal from the Commission after consulting the European Parliament; in cases of urgency the Council would have to decide within a fixed delay; its President would participate in the Eurofed Council without the right to vote and represent the Community in international monetary meetings;

(c) the Commission, the executive institution responsible to the Parliament, would play, in addition to its traditional role of impulsion and legislative initiative, an essential role in multilateral surveillance: presentation of annual reports on the economic situation of Member States, the drawing up and monitoring of multiannual guidelines, the drawing up of recommendations for economic policy; moreover, it would monitor the consistency between monetary and the general economic policy adopted at Community level and would make observations, as appropriate; a Member of the Commission would participate in the Eurofed Council without the right to vote and assist the President of the Ecofin Council in international monetary meetings;

(d) the European Parliament would be consulted on the nomination of the President of Eurofed, the definition of multiannual guidelines, the granting of special financial support, and on the recommendations; in urgent cases it would have to give its position within a prespecified time-limit; it would regularly debate the Community's economic and monetary policy, with a general debate held once a year during which it would give a discharge to the Commission in respect of its economic policy responsibilities; the President of Eurofed would regularly, and whenever exceptional circumstances make it necessary, report on monetary policy; the President of the Ecofin Council and the Commission would regularly report on the economic situation in the Community and would associate Parliament closely in the multilateral surveillance exercises;

(e) Eurofed would be responsible for the tasks set out in 5.1 (b); also, it would be consulted by the other institutions on matters of their competence relating to its objectives and tasks; in this spirit it would participate in multilateral surveillance exercises; it would also assist the Ecofin Council in international monetary meetings; it would regularly report on monetary policy to the European Council and to the European Parliament.

European Communities — Commission

**Economic and monetary union**

Luxembourg: Office for Official Publications of the European Communities

1990 — 40 pp. — 17.6 x 25.0 cm

ES, DA, DE, GR, EN, FR, IT, NL, PT

ISBN 92-826-1825-0

Catalogue number: CM-59-90-928-EN-C

Price (excluding VAT) in Luxembourg: ECU 5