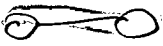


COMMITTEE FOR THE STUDY OF
ECONOMIC AND MONETARY UNION

31st January 1989

For the discussions of the Committee at its forthcoming meeting on 14th February, please find attached the draft of the revised Part II of the Report (CSEMU/10/89) and a brief note on "Propositions relating to the ECU" (CSEMU/9/89).

Suggested Amendments by Pierre Jaans



II.1.1.
(page 1)

There is no precedent in modern history for the establishment of an economic and monetary union in the absence of or before reaching political union. Actually in all cases it was political union which gradually brought about monetary and economic integration. Insofar the Community would be treading experimental ground.

Moreover historically monetary unification provided a solution to an urgent need for improvements in deficient circuits of payments and credit, while today financial markets are highly sophisticated and fully able to meet the needs of our economies and of international trade.

II. How to define the final stage of economic and monetary union

1. Introduction

1. ^{emerge as a} ~~represent the~~ The establishment of an economic and monetary union ^{without a political union is expected to} will result of the process of progressive economic integration in Europe. This result will have been attained when the Community forms a single currency area in which all residents can engage freely and without impediment in any kind of economic activity, subject only to commonly applied or mutually recognised rules and regulations and supported by economic policies geared towards price stability, balanced growth and converging standards of living, high employment and external equilibrium.

P towards economic integration
2. The EC Treaties, as amended by the Single European Act, provide the legal foundation for many of the necessary steps. However, the existing Treaties do not suffice for the creation of an economic and monetary union. The realisation of this objective calls for new arrangements which can only be established on the basis of a new Treaty and consequent changes in national legislations. For this reason the union will have to be embodied in a Treaty which clearly lays down the basic functional and institutional arrangements, as well as provisions governing their step-by-step implementation.

3. Even with a single market, a unified monetary system and an institutional and functional framework for economic management, the Community will continue to consist of independent nations with differing economic characteristics, traditions, social customs and languages. The existence and preservation of this plurality and diversified structure necessitate that a large degree of autonomy in economic decision-making should continue to rest with individual member countries and that a balance

P, in the absence of a political union, a delicate

~~II.1.4.~~

II.1.4.
page 2

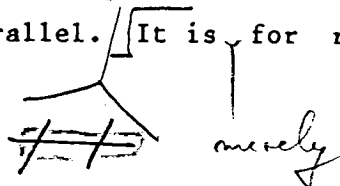
The experience with the EMS shows that monetary cooperation on a voluntary basis and centered around one currency with an international status as the anchor of the system, can influence and enhance a parallelism of fiscal and economic policies. The goal of EMU, however, is of a different political quality since it implies common decision making of a binding nature and giving up sovereignty in core areas. This goal can only be achieved in ^apolitically satisfactory and durable way if common decision making in fiscal and economic policies, that is if decision making in the core domain of elected parliaments and governments, takes the lead role on the way to EMU.

be struck between national and Community competences. For this reason it is not possible simply to model an economic and monetary union for the Community on the example of existing ~~economies~~; it is necessary to develop an innovative and unique approach. *federal states,*

An essential element of any approach consistent with the historical and economic conditions in member countries is 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~~ ^{and} subsidiary to those of lower levels. Thus, the attribution of competences to the Community must be ~~narrowly~~ confined to those areas in which collective decision-making is necessary, whereas all policy functions which can be carried out at national (or local) levels without adverse repercussions on the cohesion and functioning of the economic and monetary union must 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 a new structure to enable policy decisions to be taken at the Community level arises primarily - though in differing degree - in the field of macro-economic management. As a monetary union requires a single monetary policy, the responsibility for the formulation of this policy as well as decisions on day-to-day operations must be vested in one decision-making body. In the field of fiscal policy the need for centralisation is less imperative and a wide range of budgetary decisions should be left to national authorities. At the same time, however, all member countries will have to ~~recognise and~~ accept in their decision-making ~~the existence of~~ the constraints on national fiscal policy that emanate from participation in an economic and monetary union.

4. 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 must therefore be implemented in parallel. It is for reasons of



(vague)
 ~~certain~~
 ~~especially~~
 ~~on the~~
 ~~allocation~~
 ~~of budgetary~~
 ~~means,~~

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

2. The principal features of monetary union

5. A monetary union describes a single currency area, which, as already stated in the 1970 Werner Report, is realised when three conditions are fulfilled:

- 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. A monetary union will, however, be accomplished only when the decisive step is taken to lock irrevocably the exchange rates between Community currencies. This will be the single most important step towards creating a situation in which all currencies can be used equally to set prices, make payments and denominate debts or credits.

6. The three above-mentioned conditions are sufficient for the establishment of a single currency area, but would not necessarily mark the end of the process of monetary unification in the Community. At a later stage the adoption of a single currency, while not strictly necessary for the creation of a monetary union, may be seen - for economic as well as psychological and political reasons - as a natural and desirable further development of the monetary union. In this connection, the Committee endorses the idea that ~~the ECU should become~~ the future currency^p of the Community ~~and that an official declaration to this effect should be made at~~

L - 1 of P should be the successor and keep the name of the ECU

~~the time of the decision to draw up a new Treaty.~~ While the Treaty should allow for an appropriate period of transition, this would mean that ultimately the ECU would replace existing national currencies to serve as the only 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 and when market forces had fostered a spreading use of the ECU in commercial and financial transactions.

As a result of the permanent fixing of exchange rates national currencies ~~will~~ ^{would} become increasingly closer substitutes ^{and} their interest rates ~~will~~ ^{would} tend to converge ~~and differences between prices of goods traded throughout the Community will largely disappear.~~ However, the pace with which ^{these} developments take place will depend critically on the extent to which ~~firms, households, labour unions and other~~ economic agents are convinced that the decision to lock exchange rates will not be reversed. Initially, the continuing existence of national currencies may leave doubts about the commitment to unchangeable exchange rate parities and 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 will be crucial in dispelling such doubts over time.

7. The successful functioning of a monetary union in which national currencies co-exist has far-reaching implications for the formulation and execution of monetary policy in the Community. The adoption of permanently fixed exchange rates in an environment of free and fully integrated capital and money markets generates the need for a single monetary policy carried out through new operational procedures and not simply through the co-ordination of as many national monetary policies as there are currencies participating in the union. This, in turn, requires the attribution of the responsibility for monetary policy to a new institution (the principal features of which are outlined in Section 4), which will not only form the basis for centralised and collective decisions on the expansion of money and credit in the Community, but will also possess the necessary financial means ^{as well as} and attributes (~~i.e. its own balance sheet~~) and the regulatory powers to enforce implementation of the chosen policy. One possibility for managing a common monetary policy might be to employ the official ECU as a common

definitely the official ECU in its present definition will not be adequate for the job. Would the distinction "official" / "private" at all be meaningful at that stage of the process?

reserve instrument which, firmly controlled by a central monetary institution, would determine the scope for national monetary expansion in line with the Community's monetary policy stance. ^{The same result} ~~Could another~~ ^{would be achieved by choosing} ~~possibility be for~~ one of the existing national currencies ~~to be chosen~~ ^{by using it} as the anchor of the System and ~~managed~~ ^{managed} collectively in the framework of the European System of Central Banks ~~FF~~.

This shift from national monetary policies to a single monetary policy is an inescapable consequence of entering a monetary union and marks one of the principal institutional changes required by economic and monetary union. In practice, however, the incision will not be so deep but rather will 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 have created a situation in which the conduct of a completely autonomous monetary policy at the national level has been rendered much more difficult. 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 it will only be possible for monetary policies to be effective if they are merged into a single mould.

8. The decision to lock exchange rate parities between national currencies irrevocably will have profound effects on the functioning and the performance of the economy of the Community. ^{on the other hand of} A monetary union will remove exchange rate uncertainties and lower costs of transactions between residents of different countries in the Community. ~~This will provide a stimulus to intra-Community trade and contribute to a more efficient allocation of resources, and thereby raise the level of economic activity and employment in the Community.~~ At the same time, movements of exchange rates unwarranted by fundamental factors can no longer be a source of macro-economic disturbances and competitive distortions. Moreover, once the locking of exchange rates has gained credibility in the market place, firms and households in all countries are

The most serious problem...
 (p. 6)
 gross exaggeration!

II.2.8.
page 6

The most serious problem posed by a monetary union is that with irrevocably fixed exchange rates and balance-of-payments figures downgraded to mere statistics, two highly sensitive and visible indicators for the adequacy and credibility of monetary and fiscal policies would cease to provide a guidepost for policy making and a source of pressure for timely policy corrections when economic disequilibria developed and persisted.

Thus under a regime of monetary union economic imbalances between member countries may either remain undetected for a while or they may be the subject of political controversy between member countries with no action being taken. In both scenarios the consequences may be for those countries, which under a regime of "stable but adjustable exchange rates" would have experienced a forceful pressure to devalue their currency, that their economic competitiveness erodes in a malignant, because scarcely perceptible, process and that the damages, when their perception in the end becomes politically unavoidable, are quite severe and longer lasting in terms of desindustrialization and endemic unemployment.

To the extent

likely to ^{reduce transactions of a hedging or speculating nature} (behave more conformably) and will thereby contribute to the evolution of a more homogeneous economic structure in the Community.

[Finally, the creation of a single currency area in combination with an unrestricted common market will mean that the Community will be much less susceptible to external shocks.]

~~①~~ The most serious problem posed by a monetary union is that the exchange rate can no longer serve as an instrument for adjusting economic imbalances among member countries. To the extent that market mechanisms do not perform an adequate equilibrating role, other policies, such as income, fiscal and structural policies, will have to be used more intensively to bring about the corrections in cost and price trends that used to be obtained from time to time by realignments of exchange rate parities. For this reason the implementation of a monetary union must be accompanied by parallel progress in creating or strengthening effective alternative adjustment mechanisms, such as those discussed in the next section. Moreover, while the freezing of exchange rate relationships will not eliminate the possibility of imbalances between the supply of and demand for economic resources in individual Community countries, the statistical measurement and the economic interpretation of such imbalances may become more difficult in a fully integrated market since balance-of-payments disequilibria would essentially assume the meaning of regional imbalances. As a consequence, balance-of-payments figures, which are currently a highly visible and sensitive indicator of economic disequilibria, would no longer be able to play a significant role as guidepost for policy-making. Moreover, with parities irrevocably fixed, foreign exchange markets would cease to provide a source of pressure for policy corrections when economic disequilibria developed and persisted. However, the balance between the economic benefits and costs of exchange rate fixity will become more and more favourable as the Community develops into an optimum currency area. In order to tilt the balance in this direction it is essential that the move towards monetary union should be coupled with measures designed to strengthen the mobility of factors of production and a close co-ordination of non-monetary policies.

9. In summary, the realisation of a monetary union means that in a situation of free capital movements and full financial integration the exchange rates between Community currencies are irreversibly fixed. This

?
At the level of "national regions" the contrary may be true!!

Proceeded or at least closely

better avoid this catch-word

to be inserted or similar paragraph on page 6

will create a monetary union in which, at least initially, all national currencies circulate 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 implies a fundamental change in the economic management of the Community. National monetary policies will 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 implies the abandonment of the exchange rate as an instrument of adjustment of imbalances among Community countries and therefore requires, in ^{close} parallel to the process of monetary integration, measures to co-ordinate effectively policies in non-monetary areas.

3. The principal features of economic union

10. The definition of economic union is less straightforward than that of monetary union. It certainly comprises the complete freedom of movement of persons, goods, services and capital, and it also includes a certain amount of public functions carried out through regulation, taxation and expenditure. The scope of these functions, however, as well as their distribution between central and local governments, varies from country to country and has evolved historically. This is why, in defining the essential elements of economic union, the Community should be guided by two basic criteria: consistency with the principles that define the economic order of the Community countries, and a guarantee of appropriate balance between the economic and the monetary components of the union.

As regards the first criterion, beyond the differences that may exist between member countries or - within the same country - in different political periods, the 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 is limited by adherence to the principle of subsidiarity and by the fact that certain fundamental functions are at present exercised at the national level.

As for the second criterion, a balance between the economic and the monetary components of the union is essential because of the close interdependence between real and monetary developments and the strong interactions between economic and monetary measures. As a consequence, there is a need for common policies effected at the Community level and for close co-ordination of national policies. Without a coherent set of non-monetary policies at the Community and national levels it would be impossible to maintain permanently fixed exchange rates between Community currencies; conversely, without a monetary policy in support of a single currency area, the Community would not be able to develop into a full economic union.

The creation of a single market in Europe, which constitutes a major component of economic union, 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.

11. In a situation of irrevocably locked exchange rates this process will benefit from a monetary environment of greater certainty, but - as previous historical experience shows - it will also encounter certain economic risks. This is 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, while exchange rate realignments will not be available as an instrument in support of adjustment. Moreover, economic imbalances emanating 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 cannot be corrected by exchange rate changes but, as pointed out in the previous section, will have to be eliminated largely by

Recognised and other policy measures. Only if such imbalances can be ^preduced rather quickly or their emergence be avoided altogether will it be 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.

12. It is primarily for these reasons that the creation of an economic union requires action in three interrelated areas: measures to create a larger market without internal frontiers and to strengthen its functioning; 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; arrangements which make it possible 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.

13. The measures aimed at creating and strengthening the market are to a large extent envisaged in the EC Treaty and the Single Act establishing, by 1992, a single market without internal frontiers. ^F~~The creation of this market presupposes a~~ "level playing-field" for all residents of the Community, which allows them to make decisions on production, investment and consumption in broadly similar conditions and on the basis of similar levels of information. ~~To this end~~ ^{and} all barriers which tend to separate markets along national borders ^{would} ~~have to~~ be eliminated. ^FIn particular, all technical and regulatory obstacles have to be removed, norms have to be harmonised or mutually recognised, and certain common minimum standards governing social policy and consumer and environmental protection have to be agreed. Moreover, tax treatment must not discriminate in favour of or against economic activities across Community countries. At the same time, competition policy - conducted at the Community level - has to operate in such a way that access to markets is not impeded and market functioning not distorted by the behaviour of private or public economic agents.

In addition to clearly formulated policies for the dismantling of barriers and the prevention of restrictive practices, efforts may also have ~~to be made to encourage the adoption by all countries of wage setting~~

F Since this process is well under way, this report needs not enter into the details which are familiar. As a result of this process there should be

~~procedures based on productivity developments and to strengthen the regional and occupational mobility of labour.~~

14. Community policies to complement the single market are necessary because, even in a large economic space without internal frontiers, market forces cannot be expected to lead, on their own, to an optimal allocation of resources and a balanced distribution of wealth throughout the Community. Such policies are needed in a wide range of areas, such as agriculture, transport, research and technological development, environment and, in particular, regional and structural development. Unless the move to economic and monetary union is postponed until a distant date at which all Community countries have reached a broadly similar stage of development, the creation of a single market and the locking of exchange rates will take place in a situation in which owing to ill-adapted structures and differences in productivity, some major regional disparities will exist. The impact of economic and monetary integration on these disparities is difficult to assess: on the one hand, 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, and could therefore produce undue economic and political tensions arising from possible dislocations of industries and labour forces. On the other hand, however, economic integration would also provide less developed regions with lower wage levels a unique opportunity to attract modern and rapidly growing service and manufacturing industries for which the choice of location is much less determined by transport costs and market proximity. In order to encourage and guide the necessary structural adjustment which will help the Community's poorer regions to catch up with the wealthier ones, the Community must develop an effective policy and be endowed with adequate financial resources which will allow it to assist regional development efforts undertaken at national levels.

An important step in this direction was taken in February 1988 with the decision to enlarge considerably the resources of the Community's structural funds and to reorganise structural policies. The principal objective of these policies would 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. The success of these policies hinges not only on the size of the available financial resources, but to a decisive extent also on the effectiveness of the investment programmes. Indeed, the more recent experience of countries inside and outside the Community has shown that structural and regional development programmes are particularly successful when improvements in the resource base of regions encouraged by investment in infrastructure and education are reinforced by decentralised initiatives for local entrepreneurship, modernisation of urban areas and local institutional arrangements favouring development. It is precisely in this respect that the Community's structural policies have been revised. A longer-term approach in this area will offer countries with lower levels of productivity an appropriate period of transition and in this sense constitutes an essential element of the policy mix to ensure continuing economic integration and the attainment of economic and monetary union.

Furthermore, as long as wage flexibility and labour mobility have not increased considerably, changes in competitiveness in different regions of the Community could lead to relatively large declines in output and employment in areas with deteriorating competitiveness. In order to ease 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 may be provided by spontaneous capital flows and should prompt the recipient to intensify rather than delay economic adjustment. It would therefore have to play a role similar to that of conditional balance-of-payments assistance available under present monetary arrangements.

15. Macro-economic developments are the third area in which action is required. While policies to ensure a proper distributional and allocative functioning of the market without frontiers will have to be formulated and, in part, executed at the Community level, many of the developments on which macro-economic conditions depend will continue to be determined by factors and decisions operating at the national level. This applies not only to wage negotiations and other market-determined behaviour, but in particular also to budgetary policies. Apart from the relatively small Community budget, such policies will necessarily remain the preserve of member states even at the final stage of economic and monetary union, unless the decision

was taken that major public goods constituting the bulk of public sector activity (internal and external security, justice, social security, environment) should to a large extent be provided at the Community level, thereby significantly enlarging the Community budget. In any event, adherence to the principle of subsidiarity implies that Community competence be kept to a minimum.

However, with budgetary and other relevant decisions being taken at national levels, an economic and monetary union can only operate on the basis of mutually consistent and prudent behaviour by governments, unions and other economic agents in all member countries. In particular, unco-ordinated and divergent national budgetary policies might not only undermine monetary stability, but would also generate imbalances in the real and financial sectors of the Community and render it difficult, if not impossible, to pursue appropriate macro-economic policies for the Community as a whole. This is why all countries will have to accept that sharing a common market and a single currency area imposes narrow constraints on their national 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.

To some extent market forces will exert a disciplinary influence because financial markets, consumers and investors will respond to differences in macro-economic developments in individual countries and regions, assess the budgetary and financial position of different countries, penalise excessively expansionary fiscal behaviour or wage settlements, and thus exert pressure for sounder policies. However, experience suggests that market perceptions do not necessarily provide strong and compelling signals. 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 may either be too slow and weak or too sudden and disruptive. For this reason an economic and monetary union requires arrangements which effectively ensure a close and flexible co-ordination of national fiscal policies.

In the macro-economic area, therefore, the aim must be to set up arrangements which will enable the Community to monitor its overall economic situation, to assess its consistency with regard both to

individual countries and to common objectives, and to formulate guidelines for policy. This is particularly important for fiscal and budgetary policies, where arrangements are required which will effectively limit the scope for budget deficits that can be incurred by individual member countries of the Community. Safeguards in this respect will have to include (in accordance with the criteria laid down for a European System of Central Banks) strict limits on the maximum permissible access to monetary financing, as well as on borrowing in non-Community currencies. In addition, agreement must be reached on a system of rules which limits the maximum size of national budget deficits. Finally, co-ordination arrangements in the fiscal field must enable the Community to conduct a coherent mix of fiscal and monetary policies, i.e. to dispose of a system of rules that can be applied with a view to determining the aggregate balance on national budgetary positions, including that of the Community.

16. In summary, the establishment of an economic union implies:

- 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, and regional and structural development which will help to exploit the full potential of the single market and its role in the allocation of resources, but which will also help regions with lower productivity to catch up with the richer parts of the Community;
- a framework for monitoring and co-ordinating general macro-economic developments in the Community with a view to attaining non-inflationary, balanced economic growth;
- rules setting maximum possible deficits for national budgets and strict limits on both monetary financing and borrowing in third currencies;
- effective procedures for the co-ordination of national budgetary policies to avoid undesirable repercussions on monetary policy.

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

4. Institutional arrangements

17. Management of the economic and monetary union therefore calls for an institutional framework which will allow policy to be decided and executed at the Community level in those economic areas that are of direct relevance for the functioning of the union. The institutional framework should guarantee efficient economic management, properly embedded in the democratic process. The creation of a monetary union necessitates 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 establishment of economic union does not 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, require a revision and ~~possibly~~ some restructuring of existing Community institutions.

18. The need for a new monetary institution arises because a single monetary policy cannot be decided and implemented independently by different central banks and because decisions concerning day-to-day monetary policy operations must be centralised if they are to respond quickly to changing market conditions. For these reasons the Community's domestic and international monetary policy must be organised in a European System of Central Banks (ESCB). The System 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 be responsible for formulating the thrust of monetary policy and managing the Community's exchange rate vis-à-vis third currencies. The day-to-day operations conducted at the Community level, ~~possibly~~ involving changes in interest rates and the use of other policy instruments, would be carried out under the responsibility of the Board of the central institution, supported by its own staff. The national central banks would be entrusted with the

implementation of policies at the regional level in accordance with guidelines established by the Council.

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

Structure and organisation

- a federative structure, since this corresponds best to the political structure of the Community (e.g. a European Central Bank Council representing all the central banks in the union);
- a centralised body (Board with its supporting staff) responsible for the implementation of Council decisions as far as they apply at Community level;
- appointment of members of the Board for relatively long periods on an irrevocable basis;

Mandate and functions

- [- the mandate of the System must be to maintain the stability of money as the prime objective of the Community's monetary policy. While fulfilling this task, the System has to support the general economic policy of the Community. Stability of the currency in terms of prices must take precedence over exchange rate stability;
- the System will be responsible for the formulation of monetary policy at the Community level, for the co-ordination of policy implementation at the regional level and for the maintenance of a properly functioning payment system;]

or, alternatively

- [- a commitment 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 non-inflationary economic growth as well as to maintain a properly functioning payment system;]
- the System will 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;

- national central banks remain responsible for policy implementation at the regional level;

Status

- independence of instructions from national governments and Community authorities;
- a proper democratic legitimisation which might be achieved through regular reporting to [a committee of the European Parliament and the Council of Ministers] and through [the European Parliament and the Council of Ministers] participating in the appointment of the members of the Board;
- ~~supervision of the administration~~ of the System independently of the Community bodies, for example by a supervisory council or a committee of ~~independent auditors,~~
- submission of an annual ^{audit} report by the ESCB to the Council of Ministers and the European Parliament;

Policy instruments

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

Seat of the institution

- to be decided.

This is not a basic principle

19. The institutional requirements for effective conduct of economic policies should be assessed in the light of the functions which will be performed at the Community level. As noted in the previous section, there are three broad areas in which the Community has to be involved: firstly, the establishment and maintenance of a single market for persons, goods, services and capital; secondly, the formulation and implementation of

common policies aimed at strengthening and balancing the process of market integration; and thirdly, co-ordination of macro-economic policies, in particular with a view to promoting prudent ^{and budgetary} fiscal behaviour, avoiding inappropriate divergences between national ^{budgetary} fiscal policies and formulating a macro-^{budgetary} fiscal policy stance of the Community.

The necessary institutional framework for performing these three 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 an ~~flexible and~~ effective conduct of policies in those economic areas in which the Community is involved, two basic requirements have to be fulfilled: firstly, to the extent that policies are decided and enacted at the Community level, there must 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 is restricted to the co-ordination of national policies, its task must be guided by a system of rules which are accepted by, and can be applied 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.

In order to be able to carry out their functions within the existing institutional framework, the Community bodies must possess adequate instruments and means. As far as the implementation of the single market 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 to put the internal market programme into effect.

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 policies have recently been put in place, involving both a doubling of the resources of structural funds and a reorganisation of policies. At a more advanced stage of the process these mechanisms might be further extended and made more effective.

In order to enable the Community to pursue an appropriate macro-economic policy, new procedures, taking due account of the basic principle of subsidiarity, will have to be developed. This applies particularly to the area of public revenue and expenditure where competences will be mixed, with the bulk of the budgetary decisions being made at national level and Community budgetary decisions being confined to the limited expenditures and revenues required for the purpose of common policies. These procedures must define and maintain a fair balance between co-ordination through rules fixing a set of objectives and constraints and discretionary co-ordination adapted to a particular economic situation. This implies a need for 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 objective of the co-ordination of macro-economic policies is to determine a strategy for growth and employment in an environment of price stability and economic cohesion. For this purpose co-ordination must aim at: defining medium and short-term policy approaches, bearing in mind all their economic and social implications; setting a multi-year framework for national and Community budgetary policies; managing common policies, particularly with a view to improving economic and social cohesion; 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 is to develop a credible procedure for joint decision-making on the overall stance of fiscal policy, i.e. the size and the financing of the aggregate budgetary position in the Community. In this context the Community must be given the possibility of directly influencing the budgetary policies of individual member countries through a system of rules ^{binding} and by collective decisions. ~~However, given the fact that the ultimate budgetary decision-making power will rest with national parliaments, the system of rules can serve essentially only as a framework for increasing the transparency of the co-ordination process, which, for example through public announcement of limits on budgetary positions, could help to exert greater peer pressure.~~

While the involvement of the Community in non-monetary policies will be based on the existing institutional setting, it is of paramount importance that the ensuing policy decisions should result in a coherent

!!
This is not
economic
union!

and consistent set of measures which clearly signal the Community's policy stance. Without an unequivocal formulation of non-monetary policies, in particular in the ~~fiscal~~ ^{budgetary} field, the responsibility for macro-economic policy for the Community as a whole would fall virtually entirely to the European System of Central Banks. This would ~~not only cede too great a responsibility to the monetary authorities, it~~ would ~~also~~ leave the Community with only one macro-economic policy tool and therefore significantly impede an effective policy geared to stability and growth. *In abolition the wide effects of an overburdened monetary policy can carry a disproportionately high social cost.*

20. The new Treaty laying down the programme, procedures and organs of the economic and monetary union will create a situation in which the existing Community institutions (European Council, Council of Ministers, European Parliament, Commission, and Court of Justice) will be supplemented by a new institution of comparable status, the European System of Central Banks. Relationships and interactions between these bodies will 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 fiscal and monetary policies. To this end appropriate and regular relations between the existing institutions and the European System of Central Banks must be established which 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. 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. Moreover, the involvement of the European Parliament and national parliaments in the co-ordination process should be strengthened and the European Parliament should 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.