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The Werner Report revisited

The Werner Report on the realisation by stages of economic and monetary union was drawn up against the background of the end of the transitional period leading to the completion of the customs union and the definition of the Common Agricultural Policy. The Hanover Council has asked that renewed impetus should be given to the objective of economic and monetary union in the light of the adoption of the Single European Act and the fact that the process of completion of the internal market programme has now reached a point at which it is irreversible.

This discussion paper first outlines the main features of the Werner Report and its legislative follow-up. It then gives an assessment of the Report itself and its implementation. Finally it discusses some major developments during the post-Report period.

I. Main features of the Report

The Werner Report gave a comprehensive definition of the final objective, which it said should be achieved by stages. A detailed description of the measures needed for implementing the first stage was, however, not matched by an examination of the process by which one stage would lead to another and to the final objective. The second stage was essentially to have been a reinforced first stage. The Report also paid relatively little attention to institutional matters.

1. The final objective

Economic and monetary union, the Report said, would make it possible to "realise an area in which goods, services, people and

multilateral surveillance procedures and currency arrangements have been developed.

2. Policy consensus

Towards the end of the 1960s there was a remarkable consensus on policy-making. The evidence seemed to strongly confirm the effectiveness of medium-term planing and fine-tuning. In the 1970s experience with stagflation destroyed this consensus. Now a new consensus has developed in which attention has shifted towards medium-term financial stability, the supply side of the economy and structural policies. Part of the legacy of the earlier consensus is, however, large budget deficits and a high level of government debt. When the Werner Report was drafted, budgets in the Community were in approximate balance. Deficits subsequently peaked at over 5% of GDP and are still above 4%. Government debt at the beginning of the 1970s averaged less than 40% of GDP, whereas it now averages over 70%.

3. The Community

(a) Significant non-monetary developments

Although the Community entered a difficult phase as it absorbed new members within an unchanged framework and in an unfavourable economic environment, a number of steps were taken. Among these, as well as enlargement itself, were the following:

- in 1974 the European Council was created to take the place of the earlier summit meetings held at irregular intervals; it became the driving force of the subsequent development of the Community;
- in 1975 the first European Regional Development Fund was set up, representing the beginning of a growing redistributive role for the Community budget;
- in 1977 the Sixth VAT Directive establishing a uniform basis for collection was adopted, marking a major step in the process of tax harmonisation;

- in 1979 the first direct elections to the European Parliament were held, broadening the democratic basis of the European structure.

(b) Monetary developments

The European Monetary System was created in 1979, with the primary objective of establishing a zone of monetary stability, involving both low inflation and stable exchange rates. The exchange rate constraint has acted as a focal point for improved policy co-ordination, and the EMS has provided a framework for enhancing multilateral surveillance within the Community. Participants have gradually opted for a strong currency policy stance, so putting the greatest emphasis on domestic adjustment measures. The system has evolved in response to changes in the economic and financial environment, especially improved convergence and increased capital mobility. Most recently, the Basle/Nyborg Agreement of September 1987 made some important modifications to the mechanisms of the system to secure a more balanced implementation of the exchange rate commitment by all participants. The procedures for surveillance were also strengthened.

The use of the ECU within the system has been limited. By contrast, the non-official use of the ECU, especially as a denominator of financial transactions, has increased considerably. International banking business in ECU has expanded markedly and a significant share of international bond issues is now denominated in ECUs. The non-financial use of the ECU, however, has remained limited although some increase appears to have taken place recently.

(c) New Community impetus in the 1980s

The internal market. In 1985 the programme for completing the internal market was proposed by the Commission and adopted by the European Council. It aims, as already stated in the Werner Report, at achieving full freedom of circulation of goods, services, people and capital by 1992, and to this end calls specifically for the removal of all physical, technical and fiscal frontiers.

In November 1987 proposals for the creation of a European financial area, including the full liberalisation of capital movements,

were tabled. These were adopted by the ECOFIN Council of June 1988 and will be implemented by most members states by 1990. The early implementation of full capital mobility will entail further developments in other areas. For example, since it will increase the potential for exchange rate instability, it will be necessary to further reinforce co-operation within the EMS. Also, as the Werner Report recognised, measures will have to be taken so that differences between tax regimes do not lead to distortions or increased tax evasion.

The Single European Act is the first significant modification to the Treaty of Rome. Its enactment was possible because the internal market programme laid out in the White Paper of 1988 had given the Community a new and concrete objective, together with a more streamlined method of implementation based on mutual recognition rather than full harmonisation and a fixed timetable. The Single European Act makes changes that are vital to ensuring that the internal market programme can be completed within the specified time scale. In particular it greatly expands the scope of majority voting and lays the basis for an improved institutional balance within the Community with a strengthened role for the European Parliament. The Single European Act not only deals with the internal market but also sets objectives and provides for action in the following related areas: social policy, economic and social cohesion, research and technological development and the monetary capacity of the Community.

Accompanying policies. The Brussels European Council of February 1988 agreed on a package of measures which, as well as putting the Community budget on a solid basis and reinforcing the reform of the Common Agricultural Policy, will lead to a doubling in real terms of the Structural funds. By 1992 Portugal, Greece and Ireland will be receiving inflows of grants and loans from the Community amounting to between 3 1/2 and 6 1/2% of their GDP (and hence 15 to 30% of their gross investments). Transfers to Spain and Italy could amount to something of the order of 1% of GDP.

V. Conclusions

The link between the free movement of goods, services and capital and the need to create an economic and monetary union was the point of departure of the Werner Report; and the mandate from the Hanover Council

also comes at a time when significant progress is being made towards completing the internal market. The two processes are self-reinforcing, and the full potential of the single market will only be realised with satisfactory monetary arrangements.

Since the Werner Report was written many of its recommendations have been implemented and there have been significant developments going beyond those that the Report considered to be necessary for the first steps towards economic and monetary union. That ultimate goal, however, still remains unachieved. This is partly because of unfavourable external circumstances, but also because of intrinsic weaknesses in the approach and inadequate implementation. A better understanding of these shortcomings can only increase the chances of future success.

Gunter D. Baer
Tommaso Padoa-Schioppa