COMMITTEE FOR THE STUDY OF
ECONOMIC AND MONETARY UNION

22nd December 1988

Note to the members of the Committee

Please find enclosed a copy of the revised Part III of the Skeleton of the final report. It is circulated for discussion at the Committee's next meeting on 10th January 1989.

In agreement with the Chairman the following changes have been made in comparison with the previous draft (CSEMU/5/88 of 9th December 1988):

- removal of the section on "The role of the ECU", in consideration of the fact that the issues relating to a parallel currency and the ECU will be discussed in January on the basis of papers distributed by members of the Committee. The passage of the report dealing with the role of the ECU will be redrafted in the light of this discussion;
- insertion of a section on "The Treaty" (which incorporates the part on "How to proceed" previously contained in Part II.5 of the Skeleton), in accordance with the wish expressed by the Committee to deal with these issues in Part III of the report;
- incorporation of drafting suggestions made by Governor de Larosière concerning his proposal on a European Reserve Fund;
- various editorial amendments;
- preparation of an Annex containing a synopsis of Scenarios A and B.

Gunter D. Baer   Tommaso Padoa-Schioppa

COMMITTEE FOR THE STUDY OF
ECONOMIC AND MONETARY UNION

CSEMU/6/88
22nd December 1988
Draft Skeleton of Report

III. Concrete steps towards economic and monetary union

1. Principles governing a step-by-step approach

The request made by the European Council to the Committee to study "concrete steps" reflects the awareness that an economic and monetary union, as outlined in Part II of this Report, is too profound a change in the economic and institutional structure of the Community to be realised at one stroke. Households, corporations, unions and public administrations will need time to adapt their economic behaviour to a new setting. Similarly, it will not be possible to attribute new powers to the Community at once in all fields. Rather, it will be necessary to build on success and to retain the possibility of correcting the course of action in the light of new experiences.

The ambition, but also the complexity, of the final objective of economic and monetary union reinforce the need to define clearly the process which is to lead to European economic and monetary unification. The present diversity in the situations of the different European countries and the variety of areas involved - which go well beyond the economic and monetary sphere - make it necessary to be both clear and precise concerning the path to be mapped out.

The Committee is of the view that, in addition to the general principle of subsidiary explained earlier in this Report, a number of considerations have to be taken into account in designing a step-by-step approach to economic and monetary union.

(a) Discrete but evolutionary steps

The process of implementing economic and monetary union will have to be divided into a limited number of clearly defined stages. Each stage will have to represent a significant change with respect to the preceding one. New arrangements coming into force at the beginning of each stage will gradually develop their effects and bring about a change in economic reality so as to pave the way for the next stage. This evolutionary development within each stage will apply to both functional and institutional arrangements.

(b) Parallelism

Parallel advancement in many interrelated areas is an indispensable prerequisite for the avoidance of imbalances which could cause economic strains and loss of political support for the continuing process of developing the Community into an economic and monetary union. Perfect parallelism, however, at each and every point of time is impossible and could even be counterproductive. Already in the past the advancement of the Community in certain areas has been combined with temporary standstill in others, thus involving a process of only partial parallelism. A certain amount of temporary deviations from parallelism is part of the dynamic evolutionary process of the Community. However, parallelism has to be maintained in the medium term.

(c) Calendar

The Committee considers that the conditions for moving from stage to stage cannot be defined in advance. They depend on too many factors to permit the announcement of explicit deadlines. The timing of, especially, the move to irrevocably fixed exchange rates will have to be judged in the light of circumstances by those responsible, including the Centre for Economic Policy Co-ordination (CEPC) and the European System of Central Banks (ESCB), which will have been created in the second stage. A clear commitment to the final stage, as described in Part II, is however indispensable. There should be a clear indication of the timing of the first step. It should begin when the Directive for the full liberalisation of capital movements comes into force, and there should be a presumption that it will not last beyond the end of 1992.

(d) Indivisibility and gradualism

As has been said above, progress should be both evolutionary and step-by-step. There has to be a balance between the need to make significant steps and the need for gradualism. In achieving this balance it should be recognised that in certain specific areas the ultimate responsibility for given policy decisions, if not operational duties, has to be clearly defined. Unless it is unmistakable who (i.e. whether national governments or the Community; which organ or institution) has "the last word", there is a risk of market uncertainty and policy conflict.

(e) Participation

There is one Community, but not all the members have participated fully in all its aspects from the beginning. So far this has mainly been the consequence of successive enlargements and, for the EMS, of the decision of some countries not to join the exchange rate agreement. A consensus on the final objectives of the Community, as well as participation in the same set of institutions, should be maintained, while allowing for a degree of flexibility concerning the date on which some member countries join certain arrangements. The management of each set of arrangements should be the responsibility of those who fully participate in it.

2. Two scenarios in three steps

What follows are two scenarios based on the above principles. Each has three distinct steps towards economic and monetary union.

There are many similarities between the two scenarios. In both scenarios:

(i) each stage represents a significant change with respect to the preceding one, and allows for functional and institutional developments within each stage;

(ii) there are parallel developments on the economic and monetary sides;

(iii) no precise calendar is given for moving from step to step, but in both cases stage one would begin with the coming into force of the Directive for the full liberalisation of capital movements;

(iv) step three would include the passing of the definitive "gate" of the "irrevocable locking of parties", which in turn implies the coming into force of a monetary regime in which the responsibility to ensure price stability is exerted jointly through the ESCB. A parallel movement would have to be made on the economic side with an increased role for the CEPC.

The essential differences between the two scenarios primarily concerns step one, in which they take varying views on the questions of (a) indivisibility and gradualism; and (b) participation.

a. Indivisibility and gradualism

Scenario A unambiguously leaves in national hands the full responsibility for monetary decision-making in the first phase. There would be an upgrading of the procedures for policy-co-ordination both in the economic and monetary areas, but the new procedures would not be binding and no change would have to be made in either the Treaty of Rome or in national legislation. Changes in secondary Community legislation would be sufficient.

In scenario B on the other hand, although the responsibility for policy decisions would remain wholly in national hands, the first stage would include from the outset the creation of a European Reserve Fund (ERF). It would have some monetary policy instruments available to it; and would be a training ground for the conduct and formulation of the unique European monetary policy.

b. Participation

While shaped for the specific needs of the exchange rate mechanism of the EMS the first step of scenario A would be consistent with participation of all Member States of the Community. In contrast, in scenario B only those countries which fully participate in the exchange rate mechanism of the EMS would participate in the ERF.

These differences in the first stage of each scenario would entail some slight differences in their second stages. In particular, the second stage of scenario B would include the unwinding of the ERF and its absorption in the ESCB.

Both scenarios see scope for immediate and meaningful measures in both the economic and monetary areas. An important question is whether these should involve immediately some changes in national legislation. It may be thought that the political and institutional debate that would inevitably accompany any act to be taken by national parliaments should be reserved for the "big change" of a new Treaty rather than for an initial step only. On the other hand, it may be considered that this is too constraining and that immediate moves to create an embryo monetary institution should be made, even if these would require changes in national legislation.

Amongst the justifications for a more substantial first step are the following three observations.

- The creation by 1992 of a single European market for capital transactions and financial services is an irreversible process in which European countries have engaged and which requires central banks of countries participating in the EMS to improve monetary policy co-ordination at both internal and external levels.

- The sizable fluctuations within the international monetary system have led central banks to rely more heavily on intervention in the foreign exchange markets on a co-ordinated basis. However, such a policy necessarily has a direct influence on the implementation of domestic monetary policies in these countries. It is therefore necessary and urgent that central banks create means for analysing such issues on a permanent and common basis. It is not only a matter of strengthening the impact of their operations, but also of maintaining the efficiency of their monetary management both at domestic and European levels.

- The tendency of the European central banks to conduct their monetary policies on the basis of differentials vis-à-vis other countries is not necessarily conducive to fostering a monetary policy satisfactory for the Community as a whole. The creation of a common monetary think-tank for analysis and recommendations would make it possible to address this problem better. The deliberations within this monetary think-tank would in effect provide all the central banks with a better basis for setting their own national approaches in a European context while preserving full decision-making autonomy.

3. The Treaty

The implementation of economic and monetary union must, as specified in Article 102A of the Treaty, be embodied in a new Treaty. The first step of both scenario A and B could be implemented without a new Treaty. This would however be required for moving from step one to step two.

One procedure would be to conclude a new Treaty each time a political consensus to advance one step has been reached. The advantage of this procedure is that it clearly lays open at each step the political commitment. Its disadvantage is that, as well as being unwieldy and slow, the overall consistency of the process may not be sufficiently safeguarded and sight may be lost of the ultimate objective. It also carries the risk that progress in parallel between the monetary and non-monetary sides would not be respected.

The Committee is therefore in favour of concluding a single comprehensive Treaty which would formulate clearly the essential features and institutional arrangements of economic and monetary union and the steps in which it can be achieved.

The Treaty would facilitate the implementation process through the provision of "organic laws" and enabling clauses and would indicate the procedures by which the decision will be taken to move from stage to stage. Each move would require an appraisal of the situation and [unanimous] political agreement. [Should unanimity be adopted as the rule for all the stages? Who should participate in the decision? The European Council may have to take the final decision, but what say will the organs of the economic institution and monetary institution respectively have in proposing, or giving advice on, the decision?]

4. Scenario A

A(1) Stage one

(to be enacted in conjunction with the coming into force of the directive on short-term capital movements.)

In the institutional field:

- preparation and ratification of the Treaty on the economic and monetary union, with a procedure similar to the one followed for the Single European Act.

In the economic field:

- complete removal of internal barriers and liberalisation of exchanges of goods, services and capital within the Community, according to the single market programme adopted in the Single Act; strengthening of Community competition policy and of the executive and judiciary authority to identify and sanction infringements of Community law;
- full implementation of the "Brussels package" for reforming and doubling the structural funds, designed to strengthen substantially the ability of Community policies to promote regional development and to correct economic imbalances;
- replacement of the 1974 Council Decision on economic convergence by a new procedure for an increasing degree of budgetary policy co-ordination. The thrust of the revision of the 1974 convergence decision will be to strengthen considerably the possibilities for reducing fiscal imbalances, as well as for improving the assessment of the

overall policies of the Member States in the light of both their economic and social consequences and their consistency. The assessment will form the basis for a more effective co-ordination of macro-economic policies, with co-ordination being based on recommendations and carried out with due account of the views of the Committee of Governors. In particular, the revised 1974 convergence decision will:

- set up a new procedure for budgetary policy co-ordination, with increasingly precise quantitative guidelines, where appropriate, and medium-term orientations; and a programme for member countries concerned to consolidate their budgetary position [by reducing, where necessary, the central government deficit to no more than X% of GNP over a period of Y years].
- establish a process of multilateral surveillance of economic performance and policies based on macro-economic indicators. Where developments are judged inadequate or detrimental to commonly set objectives, these would trigger at the Community level recommendations and endorsements to correct national policies;
- provide for the possibility of promoting, where felt appropriate, concerted actions of the member countries;

In the monetary field:

- capital transactions: the coming into force of the June 1988 directive liberalising monetary movements in July 1990 will establish a regime of complete freedom of capital transactions. During this first stage measures will be taken to deal with both the problem of fiscal evasion caused by the full liberalisation of capital movements and discriminatory measures which risk distorting capital flows;
- policy co-ordination: the 1964 Council Decision defining the mandate of the Committee of Central Bank Governors would be

replaced by a new decision giving the Committee greater authority and visibility and making it the forerunner of the Council of the European system of central banks to be created under the new Treaty. The thrust of the revision of the 1964 Council Decision will be to encourage a strengthening of the co-ordination of monetary policy among all member countries of the Community. To this end, the Committee will be invited to:

- formulate recommendations on the overall orientation of monetary and exchange rate policy, as well as on measures taken in these fields by individual countries. In particular, the Committee would be consulted in advance of national decisions on the course of monetary policy, such as the setting of annual domestic monetary and credit targets;
- make policy recommendations to individual governments and the Council of Ministers on non-monetary policies that could affect the internal and external monetary situation in the Community, especially the functioning of the EMS. The outcome of the Committee's deliberations could be made public;
- submit an annual report on its activities and the monetary situation of the Community to the European Parliament;
- set up a sub-committee to start regular consultations concerning matters of common interest in the field of banking supervision.

In order to enhance its role in the process of monetary policy co-ordination:

- the Committee's opinions and recommendations would not have to reflect unanimity, but could be established by a qualified majority [determined on the basis of weighted votes?]; the recommendations would not be binding;

- the Committee would be chaired by a Chairman who would be elected for a period of [three] years;
- the Committee would be supported by a permanent Secretariat.

- EMS arrangements: all member countries [in a position to do so] would become participants in the exchange rate mechanism of the EMS with the same fluctuation margins; [the very short-term and the short-term financing mechanisms would be strengthened to make the system better equipped to counter, if needed, destabilising short-term capital movements;] margins of fluctuation would be narrowed from 2.25 to [1]%;
- ECU arrangements: removal of regulatory impediments that may prevent market participants using the ECU in setting prices, keeping corporate accounts, and contracting and settling any kind of pecuniary obligations. The ECU remains a basket.

A(2) Stage two

(to be enacted when the new Treaty comes into force.)

In the economic field:

- the Centre for economic policy co-ordination (CEPC) would start operating with a view to promoting convergence and co-ordination of economic policy in the Community. The Centre would be responsible for the:
  - introduction of progressively more precise rules relating to the size of the budget deficits and their financing;
  - adoption of medium-term guidelines for key financial targets and economic programmes in the member states;
  - joint adoption of budgetary objectives, when felt appropriate, as part of a co-ordinated budgetary and economic policy;

- enlargement of resources for supporting the structural policies of the Member States and strengthening the Community investment programmes in the fields of research and infrastructures;
- the Centre would also take a view on the exchange rates of the Community vis-à-vis major third currencies.

In the <u>monetary field</u>:

- creation of the <u>European System of Central Banks</u> (ESCB) described in Part II of this Report, with its decision-making organs (Council and Board), staff, balance sheet, and legal underpinnings: mandate to preserve price stability, independence, accountability, decision-making procedures. The ESCB would replace the present institutional monetary arrangements (EMCF, Committee of Governors and its permanent Secretariat). The ESCB would be initially endowed with a certain proportion of gold and third currencies, previously held as foreign exchange reserves by national central banks, as well as certain contributions of national Community currencies. The initial endowments could be increased over time.

  The <u>tasks of the ESCB</u> would be:

  - to act as a forum for [binding] ex ante co-ordination of national monetary policy targets, with monetary policy still being conducted by national central banks. The co-ordination would take place in the ESCB Council, which in addition, would take over the functions performed in stage one by the Committee of Governors. The ESCB Council would be supported by a permanent staff (which replaces the permanent Secretariat set up in stage one), and the staff would be supervised by the Board;
  - to conduct [limited] exchange market interventions, both in third currencies and within the EMS [in

concertation with central banks whose currencies were used? In accordance with guidelines established by the Council?];

- to represent the Community (together with representatives of national central banks) in international monetary meetings;
- to manage its holdings of third currencies and national Community currencies;
- to administer the short-term and very short-term financing mechanisms;
- to administer the private ECU clearing system;
- [the Chairman of the ESCB Council would attend the ECO/FIN meetings and the ESCB would make an annual report to the European Parliament? the Council?]

[N.B. Owing to the small size of ESCB interventions and to the firm control exercised by its Council (or to the provision to co-ordinate interventions with the national central banks concerned), the impact of these operations on domestic monetary conditions of member countries should be negligible. Its main function would be to provide a signal to the market.]

A(3) Stage three

(The beginning of this final stage would be marked by the definite locking of parities. This should be decided when the economic conditions in the participating countries are judged appropriate. This stage corresponds to the final stage described in Part II. It should be observed that the so-called "final stage" is not necessarily a stage beyond which the system would not be susceptible to further evolution. Rather, it is one in which the fundamental requirements of an economic and monetary union would have been fulfilled, albeit in a setting that might be subject to changes and improvements.)

In the economic field:

The authority of the Centre for economic policy co-ordination would be extended. [Following the programme set out in the new Treaty, legislative and executive measures would be taken, at the Community as well as the national level, leading to the creation of a European Fiscal Framework (EFF). Such a system would cover: essential tax harmonisation; the respective roles of national and Community budgets; "own" resources of the Community budget; the size of budget deficits and their financing;] The Centre would have the authority:

- to impose constraints on national budgets to the extent to which this is necessary to prevent imbalances that may threaten monetary stability;
- to make discretionary changes (through a procedure to be defined) in Community resources to supplement structural transfers to Member States or to influence the overall policy stance in the Community;
- to propose discretionary changes (through a procedure to be defined) in the level of harmonised taxation rates;
- to apply some form of conditionality to existing Community structural policies and to Community loans (as a substitute for the present medium-term loans facility).

In the monetary field:

- announcement of irrevocable fixing of parities between the Community currencies;
- concurrently the full responsibility for the formulation of monetary policy in the Community would be attributed to the ESCB Council, replacing the [binding] ex ante co-ordination procedure followed during the preceding stage;
- decisions on exchange market interventions in third currencies would be made entirely under the responsibility of the ESCB Council in accordance with Community exchange

rate policy; the execution of interventions would be entrusted to [one or ?] national central bank;

- the implementation of the Community's monetary policy would be carried out by the Board of the ESCB in co-operation with national central banks. In order to be able to influence overall monetary developments in accordance with the decisions of the ESCB Council, the Board would be empowered both to impose and vary minimum reserves [in ECU; national currencies, third currencies?] to be held by national central banks and to operate directly in the money markets and to set lending interest rates.

A(4) Last stage

- the ECU replaces national currencies.

5. Scenario B

B(1) Stage one

(to be enacted in conjunction with the coming into force of the directive on short-term capital movements.)

In the institutional field:

- preparation and ratification of the Treaty on the economic and monetary union, with a procedure similar to the one followed for the Single European Act.

In the economic field:

- complete removal of internal barriers and liberalisation of exchanges of goods, services and capital within the Community, according to the single market programme adopted in the Single Act; strengthening of Community competition policy and of the executive and judiciary authority to identify and sanction infringements of Community law;

- full implementation of the "Brussels package" for reforming and doubling the structural funds, designed to strengthen substantially the ability of Community policies to promote regional development and to correct economic imbalances;
- replacement of the 1974 Council Decision on economic convergence by a new procedure for an increasing degree of budgetary policy co-ordination. The thrust of the revision of the 1974 convergence decision will be to strengthen considerably the possibilities for reducing fiscal imbalances, as well as for improving the assessment of the overall policies of the Member States in the light of both their economic and social consequences and their consistency. The assessment will form the basis for a more effective co-ordination of macro-economic policies, with co-ordination being based on recommendations and carried out with due account of the views of the Committee of Governors. In particular, the revised 1974 convergence decision will:

  - set up a new procedure for budgetary policy co-ordination, with increasingly precise quantitative guidelines, where appropriate, and medium-term orientations; and a programme for member countries concerned to consolidate their budgetary position [by reducing, where necessary, the central government deficit to no more than X% of GNP over a period of Y years];
  - establish a process of multilateral surveillance of economic performance and policies based on macro-economic indicators. Where developments are judged inadequate or detrimental to commonly set objectives, these would trigger at the Community level recommendations and endorsements to correct national policies;

- provide for the possibility of promoting, where felt appropriate, concerted actions of the member countries;
- views about exchange rates of major third currencies should be taken within a Community framework.

In the monetary field:

- capital transactions: the coming into force of the June 1988 directive liberalising monetary movements in July 1990 will establish a regime of complete freedom of capital transactions. During this first stage measures will be taken to deal with both the problem of fiscal evasion caused by the full liberalisation of capital movements and discriminatory measures which risk distorting capital flows;
- EMS and policy co-ordination: following the procedure used in 1978 for the creation of the EMS (a Resolution of the European Council followed by an agreement between central banks), and complemented, as appropriate, by changes in national legislation, a reform of EMS arrangements would be implemented along the following lines:

    - creation of a European Reserve Fund, the ERF, [replacing EMCF when all EMS countries are participants] with the task of intervening in third currencies and eventually in Community currencies intramarginally or at the limit in order to supplement individual action when tensions appear. The ERF's intervention should take place after unanimous agreement has been reached between central bank members. Interventions would serve the two purposes of creating a "training ground" and providing a signal effect through concerted interventions;
    - the resources of the ERF will be provided by a pooling of reserves of the participating central banks that would represent initially 10% of their gold holding and 10% of their foreign currency holdings;
    - the ERF would ensure the management of these reserves;

- the ERF would also set up a Monetary Policy Department which would be in charge of analysing in particular interest rate trends, monetary aggregates and domestic demand. It would thereby facilitate from a Community point of view the concerted management of exchange rates and the co-ordination of monetary policies among the different participating central banks;
- this phase could go along with the creation of a monetary policy co-ordination committee, which would define common surveillance instruments, propose harmonised objectives, and would progressively graduate from an ex post analysis to an ex ante approach to monetary policy adjustment;
- all the EEC's central banks would be eligible to join the ERF. However, membership would be subject to their participation in the exchange rate mechanism and the pooling of a portion of their reserves;
- as a forerunner of the future European Central Bank or the European system of central banks, the management of the ERF would consist of:

  - a Board of Directors which would comprise automatically the Governors of each central bank participating in the ERF; [a member of the Commission would attend the Board meetings];
  - an Executive Committee whose members would be selected by the Committee of Governors on the basis of competence. This Executive Committee would be of a small size, consisting of three or four members who would have direct responsibility for the different departments of the ERF;
  - two committees: a Foreign Exchange Policy and a Monetary Policy Committee. They would report regularly to the Committee of Governors and, in the framework of a more active "monitoring", would recommend appropriate action in the field of exchange rates and interest rates;

- two departments: a Foreign Exchange and Reserves Management Department, and a Monetary Policy Department;
- [Accountability? The President of the Executive Committee would attend the ECO/FIN meetings and the ERF would make an annual report to the European Parliament? the Council?]

- ECU developments: removal of regulatory impediments that may prevent market participants using the ECU in setting prices, keeping corporate accounts, and contracting and settling any kind of pecuniary obligations. The ECU remains a basket.
- bank supervision: regular consultations concerning matters of common interest in the field of banking supervision are held within [the European Reserve Fund? the Committee of Governors];

B(2) Stage two

(to be enacted when the new Treaty comes into force.)

In the economic field:

- the Centre for economic policy co-ordination (CEPC) would start operating with a view to promoting convergence and co-ordination of economic policy in the Community. The Centre would be responsible for the:

  - introduction of progressively more precise rules relating to the size of the budget deficits and their financing;
  - adoption of medium-term guidelines for key financial targets and economic programmes in the member states;
  - joint adoption of budgetary objectives, when felt appropriate, as part of a co-ordinated budgetary and economic policy;

- enlargement of resources for supporting the structural policies of the Member States and strengthening the Community investment programmes in the fields of research and infrastructures;
- the Centre would also take a view on the exchange rates of the Community vis-à-vis major hard currencies.

In the monetary field:

- creation of the European System of Central Banks (ESCB) described in Part II of this Report, with its decision-making organs (Council and Board), staff, balance sheet, and legal underpinnings: mandate to preserve price stability, independence, accountability, decision-making procedures. The ESCB would replace the pre-existing institutional monetary arrangements (EMCF, ERF, Committee of Governors). The ESCB would take over the claims and liabilities of the ERF, assume its functions and incorporate its institutional features. Apart from the resources taken over from the ERF, the ESCB would also receive certain contributions of national Community currencies. The initial endowments could be increased over time. In addition to the tasks that had already been entrusted to the ERF in the preceding stage, the ESCB would:

  - act as a forum for [binding] ex ante co-ordination of national monetary policy targets, with the conduct of monetary policy still being left to national central banks. The co-ordination would take place in the ESCB Council (replacing the Board of Directors of the ERF), which would be supported by an [enlarged] permanent staff (incorporating the departments of the ERF), managed by the Board (replacing the Executive Committee of the ERF);
  - conduct [on a larger scale than in the preceding stage] exchange market interventions, both in third currencies and within the EMS, at the discretion of the Board, but

in accordance with guidelines established by the ESCB Council;

- represent the Community (together with representatives of national central banks) in international monetary meetings;
- administer the short-term and very short-term financing mechanisms;
- administer the ECU clearing system;
- [the Chairman of the ESCB Council would attend the ECO/FIN meetings and the ESCB would make an annual report to the European Parliament? the Council?]

[N.B. Owing to the relatively small size of ESCB interventions and to the firm control exercised by the ESCB Council (or the provision to co-ordinate interventions with the national central banks concerned), the impact of ESCB operations on domestic monetary conditions of member countries should be [rather small, negligible]. Its main function would still be to provide a signal to markets.]

B(3) <u>Stage three</u>:

(The beginning of this final stage would be marked by the definite locking of parities. This should be decided when the economic conditions in the participating countries are judged appropriate. This stage corresponds to the final stage described in Part II. It should be observed that the so-called "final stage" is not necessarily a stage beyond which the system would not be susceptible to further evolution. Rather, it is one in which the fundamental requirements of an economic and monetary union would have been fulfilled, albeit in a setting that might be subject to changes and improvements.)

In the <u>economic field</u>:

The authority of the Centre for economic policy co-ordination would be extended. [Following the programme set out in the new Treaty, legislative and executive measures would be taken, at the Community as well as the national level, leading to the creation of a European Fiscal Framework (EFF). Such a system would cover: essential tax harmonisation; the respective roles of national and Community budgets; "own" resources of the Community budget; the size of budget deficits and their financing;] The Centre would have the authority:

- to impose constraints on national budgets to the extent to which this is necessary to prevent imbalances that may threaten monetary stability;
- to make discretionary changes (through a procedure to be defined) in Community resources to supplement structural transfers to Member States or to influence the overall policy stance in the Community;
- to propose discretionary changes (through a procedure to be defined) in the level of harmonised taxation rates;
- to apply some form of conditionality to existing Community structural policies and to Community loans (as a substitute for the present medium-term loans facility).

In the <u>monetary field</u>:

- announcement of irrevocable fixing of parities between the Community currencies;
- concurrently the full responsibility for the formulation of monetary policy in the Community would be attributed to the ESCB Council, replacing the [binding] ex ante co-ordination procedure followed during the preceding stage;
- decisions on exchange market interventions in third currencies would be made entirely under the responsibility of the ESCB Council in accordance with Community exchange rate policy; the execution of interventions would be entrusted to [one or ?] national central bank;
- the implementation of the Community's monetary policy would be carried out by the Board in co-operation with national central banks. In order to be able to influence overall monetary developments in accordance with the decisions of

its Council, the ESCB would be empowered both to impose and vary minimum reserves [in ECU; national currencies, third currencies?] to be held by national central banks and to operate directly in the money markets and to set lending interest rates.

B(4) <u>Last stage</u>: the ECU replaces national currencies.

ANNEX

Synopsis of Scenarios A and B

SCENARIO A

Stage One

comes into force at the same time as the full liberalisation of capital movements. Stage one would not involve any transfer of decision-making authority from the Member States to the Community. Policy co-ordination in both the economic and monetary fields would be strengthened. This would be done in existing fora.

Institutional field

Prepare and ratify a single Treaty on all the steps towards EMU, using a procedure similar to the one followed for the Single European Act.

Economic field

Complete the 1992 internal market programme and strengthen competition policy:

implement accompanying policies and reform of structural funds to promote regional development and correct economic imbalances.

reinforce budget policy co-ordination through reform of the 1974 Convergence Decision to establish:-

- quantitative guidelines and medium-term orientations;
- a process of multilateral surveillance based on macro-economic indicators;
- the possibility of promoting concerted actions.

Monetary field

Complete the programme for the full liberalisation of capital movements.

Replace 1964 Decision defining the mandate for the Committee of Central Bank Governors to give them more authority and visibility. The Committee would:-

- formulate recommendations on monetary and exchange rate policy;
- make policy recommendations on non-monetary policy;
- submit an annual report to the Parliament;
- have a regular subcommittee on banking supervision matters;
- make its decisions by qualified majority;
- have a chairman appointed for [3] years and have a permanent secretariat.

Strengthen the EMS, by enlarging participation [by member countries in a position to do so] and narrowing the fluctuation bands.

Remove regulatory impediments to the use of the ECU.

SCENARIO B

Stage One

comes into force at the same time as the full liberalisation of capital movements. Stage one would not involve any transfer of decision-making authority from the Member States to the Community. Policy co-ordination in both the economic and monetary fields would be strengthened. A new body, the European Reserve Fund, would be created.

Institutional field

Prepare and ratify a single Treaty on all the steps towards EMU, using a procedure similar to the one followed for the Single European Act.

Economic field

Complete the 1992 internal market programme and strengthen competition policy:

implement accompanying policies and reform of structural funds to promote regional development and correct economic imbalances.

reinforce budget policy co-ordination through reform of the 1974 Convergence Decision to establish:-

- quantitative guidelines and medium-term orientations;
- a process of multilateral surveillance based on macro-economic indicators;
- the possibility of promoting concerted actions.

take a view on the exchange rates of major third currencies

Monetary field

Complete the programme for the full liberalisation of capital movements.

Set up a European Reserve Fund, composed of all Member States fully participating in the ERM.

Tasks:-

- analyse monetary developments, especially interest rate trends, monetary aggregates and domestic demand;
- define common surveillance instruments, propose harmonised objectives and progressively graduate from ex post analysis to an ex ante approach to monetary policy adjustment;
- manage the pooled reserves - 10% of gold and foreign currency holdings;
- intervene on the exchange markets after unanimous agreement between central bank members;
- [make an annual report to the Parliament].

Structure:-

- a Board of Directors comprised of the Governors of all the participating central banks; [a member of the Commission would participate];
- an executive committee of 3-5 members selected by the Board of Governors;
- a foreign exchange policy committee; and a monetary policy committee;
- a small permanent staff.

Remove regulatory impediments to the use of the ECU.

Regular consultations on bank supervision in (the ERF? the Committee of Governors)

Stage Two

comes into force with the ratification of the Treaty.
In stage two, the final word on the conduct of policy remains with the member states. There is however a transfer of some instruments of policy to the Centre but not of sufficient magnitude to overwhelm national policy decisions.

Economic field

Center for economic policy co-ordination (CEPC)

Tasks:-

- the progressive introduction of rules relating to the size and financing of budget deficits;
- adoption of medium-term guidelines for key financial targets and economic programmes in the Member States;
- joint adoption of policy measures, when felt appropriate, as part of a co-ordinated budgetary and economic policy;
- economic management of common policies and enlarged structural funds and strengthening Community investment programmes especially in the fields of research and infrastructure;
- to take a view on the exchange rate vis-à-vis major third currencies and other international monetary matters.

Its structure would be based on that of the existing Community institutions.

Monetary field

European System of Central Banks (ECSB) consisting of the Council, the Board and the staff and the national central banks.

Tasks:-

- act as a forum for [binding] ex ante co-ordination of national monetary policies;
- conduct intervention [in concertation with central banks whose currencies are used? in accordance with guidelines established by the Council?];
- represent the Community in international monetary meetings (together with representatives of National Central Banks);
- administer short and very short financing mechanisms;
- administer the private ECU clearing system.

Structure:-

- Council composed of the Governors of the national central banks and the members of the Board. The Council would meet [every two weeks] and be chaired by [the Chairman of the Board]. A member of the Commission would attend. Decisions would be made by [qualified] majority.
- Board composed of initially 3 members (the number could increase over time) appointed for [8] years by the [European Council]. It would be responsible for day to day management and be supported by its own staff.

Stage Two

comes into force with the ratification of the Treaty.
In stage two, the final word on the conduct of policy remains with the member states. There is however a transfer of some instruments of policy to the Centre but not of sufficient magnitude to affect national policy decisions.

Economic field

Center for economic policy co-ordination (CEPC)

Tasks:-

- the progressive introduction of rules relating to the size and financing of budget deficits;
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Its structure would be based on that of the existing Community institutions.

Monetary field

European System of Central Banks (ECSB), consisting of the Council, the Board and the staff and the national central banks. The ESCB would absorb the ERF.

Tasks:-

- act as a forum for [binding] ex ante co-ordination of national monetary policies;
- conduct intervention [in concertation with central banks whose currencies are used? in accordance with guidelines established by the Council?];
- represent the Community in international monetary meetings (together with representatives of National Central Banks);
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- Board composed of initially 3 members (the number could increase over time) appointed for [8] years by the [European Council]. It would be responsible for day to day management and be supported by its own staff.

Stage Three

The beginning of this stage would be marked by the irrevocable fixing of parities. This will require a shift in the ultimate responsibility for monetary policy decision-making from the periphery to the centre. There will have to be a [corresponding] shift in responsibilities for economic policy-making.

Economic field

A European Fiscal Framework (EFF) would be created.

In implementing the EFF the tasks of the CEPC would be as follows:-

- to impose constraints on national budgets to the extent to which this is necessary to prevent imbalances that may threaten monetary stability;
- to make discretionary changes (through a procedure to be defined) in Community resources to supplement structural transfers to member states or to influence the overall policy stance in the Community;
- to propose discretionary changes (through a procedure to be defined) in the level of harmonised taxation rates;
- to apply some form of conditionality to existing Community budgetary transfers and to Community loans (as a substitute for the present medium-term loans facility);
- to decide the exchange rate policy vis-à-vis major third currencies.

Monetary field

The tasks of the ESCB would be expanded to include:-

- full responsibility for the formulation of monetary policy in the Community would be attributed to the ESCB Council, replacing the [binding] ex ante co-ordination procedure followed during the preceding stage;
- decisions on exchange market interventions in third currencies would be made entirely under the responsibility of the ESCB Council; the execution of interventions would be entrusted to (one or?) national central bank;
- the implementation of the Community's monetary policy would be carried out by the Board in co-operation with national central banks. In order to be able to influence overall monetary developments in accordance with the decision of the ESCB Council, the Board would be empowered both to impose and vary minimum reserves [in ECU, national currencies, third currencies?] to be held by national central banks and to operate directly in the money markets.

Its structure would be adapted to increase the number of Board members and enlarge its permanent staff.

Stage Three

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