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and

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**Ref./Comments:**

Observations on the latest version of "The Werner Report Revisited" and brief comment on Tommaso's "Issues Paper".

If this transmission is not complete, please advise us at your earliest convenience.

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Dear Tommaso, Jean-Paul, Joly,

I. Please find below a few observations on the latest version of "The Werner Report Revisited".

1. Section I provides a very good, concise and fair summary of the main features of the Report and I have nothing to add.

2. Section II provides important factual information which, however, would seem to belong more appropriately in part 3 of Section III ("Incomplete implementation"). That part in combination with Section II might in fact be turned into a new self-contained section, perhaps entitled "Follow-up to the Report". The reason for this suggestion is that the "incomplete implementation" of the Report is not really an independent cause for its lack of success, but rather a natural consequence of changes in the economic environment and intrinsic weaknesses of the Report itself. In introducing the "Follow-up to the Report", which should come after the Assessment section, mention might be made that "both changes in the economic environment and some of the intrinsic weaknesses of the Report were - at least to some extent - responsible for its incomplete or modified implementation".

3. Section III would thus contain only two sub-sections. As regards Sub-section 1 (Changes in the international environment) the present draft does not make clear whether new economic developments made the Report obsolete or whether changes in the environment lessened the willingness to co-operate. I would therefore suggest a rewording along the following lines:

"The collapse of the Bretton Woods system together with the first oil price shock altered significantly the economic environment in which the Report was expected to be implemented. However, these unforeseen changes did not pose unsurmountable problems of a technical nature. Adaptations of the Report's technical features would have been

possible and, indeed, were to some extent attempted in the context of the "snake". Rather, the <sup>possibilities</sup> willingness to co-ordinate economic policy was greatly undermined by disagreements about the appropriate policy response to the oil shock (which contributed subsequently to the emergence of large-scale fiscal imbalances and the surge in inflation) and expectations that more flexible exchange rates would enlarge the scope for independent domestic economic management. [Policy consensus and readiness to co-operate voluntarily were, however, the most essential prerequisites for a successful implementation of the Report's first stage.]

As regards Sub-section 2 (Intrinsic weaknesses) I wonder whether if would not be clearer to organise the points in the following way:

"Insufficient constraints on national policies: While the Report advocated obligatory <sup>major</sup> consultation procedures - initially involving existing Community bodies - the thrust for a process of convergence and progressive integration rested basically on a voluntary agreement on broad Community objectives which were to be achieved through national policies carried out in accordance with guidelines. These guidelines had the character of recommendations and there was no <sup>mechanisms</sup> mechanism to ensure their observance. Such an approach could work only as long as there was sufficiently strong policy consensus and willingness to co-operate. However, once that consensus began to weaken more binding constraints on national policy would have become necessary; ~~in other words, the Report lacked safeguards against (temporary) lapses in policy consensus.~~

Institutional ambiguities: While the Report concentrated on the mechanics of how and when decisions should be made, it left somewhat unclear who should make the decision and how responsibilities were to be distributed. For instance, the Committee of Governors ... (continue with text of Monetary inadequacy). This paragraph might also incorporate the last sentence (starting with "The institutional insufficiency ...") of the paragraph entitled A lack of institutional change; I must, however, confess that I do not fully understand the relevance of this sentence.

Inappropriate policy conception: The procedures for policy co-ordination detailed in the Report assume a very high level of confidence in the ability of policy instruments to affect policy goals in a known and predictable way. This overoptimistic view of the efficacy of economic management gave rise to a rather mechanistic and relatively rigid approach to policy co-ordination (~~especially in the budgetary field~~) which left less room for discretionary and flexible policy responses than was needed in the face of changing economic circumstances.

Lack of internal momentum: I wonder whether it would be helpful to change the first half of the final sentence of the present draft as follows: "The Report did not envisage an interactive process in which the implementation of certain steps would provoke market reactions that in turn necessitated further steps towards economic and monetary union. Rather, the Report's method ..."

4. Section IV could benefit from some streamlining by subdividing it into two major parts. The first one should sum up all developments in the Community since mid-1970, i.e. it should combine the major events enumerated at the beginning of this section with what is mentioned under heading 3 The Community. The second part should describe where we stand now, dealing with both the economic environment and the policy consensus.

5. Finally, do you think it would be useful to sum up in the final section some of the conclusions that can be drawn from the experience with the Werner Report and which are relevant for the Committee's work? For example, the paper suggests that any future scheme should:

- be flexible enough to accommodate shifts in economic conditions and economic thinking;
- impose to the extent possible constraints on national policy; such constraints might be more easily acceptable at times of converging views on objectives and policies and be indispensable for continuing progress at times of differences of opinion;

- lay down as clearly as possible detailed steps with regard to measures, decision-making processes and division of responsibilities.

II. As far as Tommaso's comprehensive "Issues Paper" (dated 18th August 1988) is concerned, I think it raises all the relevant questions. While there is some - probably inevitable - overlapping of questions and while I have some slight reservations about discussing alternative models of monetary integration separately from questions relating to the currency and the monetary authority of the union, I find the note very stimulating and I do not feel that it needs to be amended before being given to M. Delors. I very much agree with Tommaso that we should discuss the note thoroughly at our meeting on 31st August 1988.

Best regards,

Gunter D. Baer