COMMITTEE FOR THE STUDY OF
ECONOMIC AND MONETARY UNION

CSEMU/6/88
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Draft Skeleton of Report

III. Concrete steps towards economic and monetary union

1. Principles governing a step-by-step approach

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 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.

a) Discrete but evolutionary steps

~~For these reasons~~ 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 a)

The Committee is of the view that, in addition to the general principle of subsidiarity explained earlier in this Report, a number of

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functional and institutional developments.

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

considerations have to be taken into account in designing a step-by-step approach to economic and monetary union.

d) ~~A first consideration concerns~~ gradualism ~~and~~ indivisibility, and ~~While the arguments above point to~~ the need for gradualism, it has to be recognised that in certain specific areas ~~policy decisions and operational~~ the ultimate responsibilities for given policy decisions, if not operational duties, ~~cannot be transferred "piece by piece" but require a quantum jump~~ has to be clearly defined. Unless it is ~~clearly indicated~~ 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 conflicts. ~~will inevitably arise. However, ... In the following, two alternative scenarios are presented, corresponding to different choices concerning gradualism and indivisibility.~~ In achieving this balance

b) ~~A second and related consideration concerns~~ 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.

e) ~~A third consideration concerns~~ 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.

c) ~~A fourth consideration concerns the~~ calendar ~~and the timing~~. The Committee considers that the conditions for ~~reaching~~ moving from stage to ~~the final~~ the stage ~~are too difficult~~ cannot be defined in advance; they depend on too many factors to permit ~~a firm~~ the announcement of explicit deadlines. ~~It has also to be considered that each stage contains a programme of legislative actions that takes time to implement,~~

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.

It should begin when the Directive for the full liberalisation of capital movements comes into force, and [3] there should be a presumption that it will not last beyond the end of 1992.

~~as well as that there is a need to test the arrangements established at the beginning of the stage. Thus a certain degree of flexibility in the calendar is necessary. However,~~ A clear commitment to the final stage, as described in Part II, is however indispensable, ~~and~~ There should be ~~at least~~ a clear indication of the timing of the first step. ~~Progress from one stage to the next will require that the monetary authorities are in full agreement not only on the medium-term direction in which they must aim their efforts and initiatives in the monetary field, but also on the day-to-day implementation of the specific policies they have to define and co-ordinate.~~

2) from page 5

3. ~~How to proceed?~~ The Treaty

The implementation of economic and monetary union must, as specified in ~~in accordance with~~ Article 102 A ~~236~~ of the Treaty ~~of Rome~~, be embodied in a new Treaty. ~~However, even after a political decision to conclude a new Treaty~~ has been taken, its drafting and ratification will require a certain time. In order not to lose momentum and to demonstrate the political determination to advance on the road to economic and monetary union, it would seem advisable to combine in a first stage the conclusion of the new Treaty with the enactment of a number of concrete measures. While the possibilities for action will have to conform with the existing legal and institutional framework of the Community, the Committee feels that there is sufficient scope for additional and meaningful measures in both monetary and non-monetary areas. However, some of these measures may, as described in the next section, require some changes in national legislations. The new Treaty would come into force at the latest at the end of the first stage of ~~the process.~~

~~Concerning the Treaty, two alternative routes are conceivable. The first route is~~ One procedure would be to conclude a new Treaty each time a political consensus to advance one step has been reached. ~~This~~ The advantage of this procedure ~~has~~ is that it ~~the advantage of~~ clearly lays open at each step the political commitment ~~to European integration and offering a high degree of participation of national governments.~~ ~~At the same time, however, this~~ Its disadvantage is that, as well as being approach is ~~not only rather~~ unwieldy and ~~bound to be~~ slow, ~~it also carries the risk that, with focus on pragmatic considerations,~~ the overall consistency of the process may not be sufficiently safeguarded and sight may be lost of the ultimate objective.

The first steps 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.

(monetary and non-monetary sides would not be respected.

It also carries the risk that progress in parallel between the ~~Moreover, while there is no doubt that upon completion of the process of integration all countries will benefit greatly from economic and monetary union, each time a decision on a new step is to be made without a firm view of the ultimate goal short-term cost considerations may be given undue weight in comparison with longer-term benefits and thus hamper the process of integration.~~

The Committee is therefore in favour of ~~An alternative route would consist in~~ concluding a single comprehensive ~~single new~~ 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. ~~as described in the preceding sections.~~ The Treaty would facilitate the implementation process through the provision of "organic laws" and enabling clauses and ~~The Treaty would then serve as a visible landmark on the way to integration~~ against which the consistency and conformity of each individual step with the final objective could be checked. Such a procedure would allow all member countries of the Community to express their agreement with the final objective of European integration while, at the same time, it would not necessitate that each step be carried out simultaneously by all countries, thus leaving room for longer transition periods for certain countries.

Taking these considerations into account the Committee feels that a step-by-step approach should be founded on two basic principles:

(a) whether it be at the monetary or economic level, it would be necessary rapidly to reach ratification of a Treaty, which would have the double advantage of:

- setting the initiatives taken in the intermediate phase very definitely and irrefutably in the context of the path laid down towards the ultimate aim of monetary and economic union. This is essential for the integrity of the final objective to be ensured and also for the process to maintain its momentum and make steady progress;
- respecting the principle of progress in parallel with that achieved in the non-monetary fields, which should also be the subject of a Treaty. This would have the effect of reinforcing these other commitments, which would ensure that the emphasis in these initial stages would not fall entirely on monetary and foreign exchange policy.

~~(b) The Treaty will~~ would indicate the procedures ~~where~~ which by the decision will be taken to move from one stage to stage ~~the next~~. ~~On the one hand, the signing of the Treaty will represent a single political decision embracing the whole enterprise of economic and monetary union and commitment thereto. On the other hand, every passage from one stage to the next will~~ 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? ~~Which body or bodies will take 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, this decision?]

2 ~~3~~. Two scenarios in three steps

What follows are two scenarios based on the above principles ~~of how to arrive at economic and monetary union in three steps. In~~ and three distinct Each ~~of the two scenarios each~~ steps ~~would be the "entry point" to a new stage of the process leading~~ towards ~~the~~ economic and monetary union.

A ~~The two scenarios have some common features. Firstly, they~~ both provide for parallel progress on the economic and on the monetary side, based on a Treaty at latest from the beginning of the second stage. Secondly, in both scenarios step three consists of passing the decisive "gate" of the "irrevocable locking of parities", 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 European System of Central Banks.

The differences between the two scenarios are spelled out in detail in Sections 4 and 5 below. They primarily concern the operational context and the legal institutional basis of the first stage. In Scenario A the first stage would consist of an upgrading of the procedures of policy co-ordination, both in the monetary and in the budgetary field. The new procedures would not be binding and no change would have to be introduced in either the Treaty of Rome or the national legislation. In Scenario B the first stage would consist of the creation from the outset of a European Reserve Fund that would be the building ground and the initial engine for European economic and monetary integration. This could require appropriate changes in national legislations.

The two scenarios also differ in that the first step of Scenario A can be applied to all member countries, while Scenario B would only be applicable to countries that choose to participate in the ERM with narrow margins.

Largely as a consequence of these differences concerning stage one, also stage two is different in the two scenarios, as shown below.

Besides these operational and legal aspects there are differences in the general philosophies underlying the two scenarios.

The general philosophy underlying Scenario A is based on two considerations. Firstly, to the extent to which a change in national legislation is deemed to be necessary to create a Fund as envisaged in Scenario B, it may be thought that the political and institutional debate that would inevitably accompany any act to be taken by national parliaments, should preferably be reserved for the "big change" of a new Treaty rather than for an initial step only. Secondly, a first stage based entirely on the existing - though strengthened - fora for policy consultation, without the creation of an embryo of a common decision-making body, would unambiguously leave in national hands the responsibility for monetary decision in the first phase of the process.

The general philosophy underlying Scenario B, based on the ~~proposal for the quick creation of a European Reserve Fund, is inspired by three observations. Firstly,~~ 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. ~~Secondly,~~ 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. ~~Finally,~~ 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.

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;

for reforming and

- full implementation of the "Brussels package" ~~of~~ doubling the structural funds, designed to strengthen substantially the ability of Community policies to promote regional development and to correct economic imbalances;

an increasing degree of

- replacement of the 1974 Council Decision on economic convergence by a new procedure for 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 of the Member States in the light of both their economic and social consequences and their consistency,

improving the assessment ~~and implementation~~ of the overall polic~~y mix~~ies ~~in the Community.~~ 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
- 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;
- contain 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].

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 ~~a directive would be adopted to harmonise tax treatment of capital revenues to~~ the extent that is necessary ~~to avoid~~ distortions ~~in~~ capital flows;

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

- 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 strengthening of ~~further~~ 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 <u>monetary and exchange rate policy</u>, 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 <u>non-monetary policies</u> 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 <u>annual report</u> 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 <u>banking supervision</u>.

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.

[in a position to do so]

- EMS arrangements: all member countries 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 ~~decisions~~ coordination (CEP~~D~~C) would start operating with a view to promoting convergence and co-ordination of economic policy in the Community. [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;]

~~[in accordance with the programme for the EFF,] this stage would include:~~

The Centre would be responsible for the

to p B

X

- 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 monetary field:

- creation of the European System of Central Banks (ESCB) described in Part II of this Report, with its decision-making organs (Board and Council), 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 endowment could be increased over time.

  The tasks of the ESCB would be:

  - to act as a forum for [binding] ex ante co-ordination of national monetary policy, with monetary policy shall being ~~executed~~ 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

targets

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) <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 Centre for economic policy ~~decisions~~ coordination would be ~~given the~~ extended authority of the ⟸ X from p 13 ⟸ The Centre would have the authority: to the extent to which

- to impose constraints on national budgets ~~when~~ 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 ~~make~~ 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~~ 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; the execution of interventions would be entrusted to [one or ?] national central banks;

in accordance with the Community exchange rate policy

- 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 leading 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 ~~of~~ 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

of the Member States in the light of both their economic and social consequences and their consistency.

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 ~~and implementation~~ of the overall polic~~y mix in the Community~~. 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:

with increasingly precise

- set up a new procedure for budgetary policy co-ordination, with quantitative guidelines, where appropriate, and medium-term orientations; and
- 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;
- ~~contain~~ 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]
- 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 ~~a directive would be adopted to harmonise tax treatment of capital revenues to the extent that is necessary to avoid distortions in capital flows;~~

as on p 8

and complemented, as appropriate, by changes in national legislation

- <u>EMS and policy co-ordination</u>: 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) a reform of EMS arrangements would be implemented along the following lines:

  - creation of a <u>European Reserve Fund</u>, the <u>ERF</u>, [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 ~~decisions~~ coordination (CEP~~D~~ C) would start operating with a view to promoting convergence and co-ordination of economic policy in the Community. ~~[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;]~~

~~[in accordance with the programme for the EFF,] this stage would include:~~

The Centre would be responsible for the

progressively more precise

- introduction of 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-a-vis major third 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 (Board and Council), 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. In addition to the tasks that had already been entrusted to the ERF in the preceding stage, the ESCB would:

Apart from the resources taken over from the ERF the ESCB would also receive certain contributions of national Community currencies. The initial endowment could be increased over time

- act as a forum for [binding] ex ante co-ordination of national monetary polic~~ies~~y targets, with the conduct ~~execution~~ of ~~these~~ monetary policy still ~~policies~~ 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 Centre for economic policy ~~decisions~~ coordination would be ~~given the~~ extended.
authority of the ← X from p 10 ← The Centre would have
the authority: to the extent to which

- to impose constraints on national budgets ~~when~~ 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 ~~make~~ 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~~ 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; the execution of interventions would be entrusted to [one or ?] national central banks;

in accordance with Community exchange rate policy

- 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) Last stage: the ECU replaces national currencies.