

CENTRAL BANK OF IRELAND

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Governor

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Dr. Tommaso Padoa-Schioppa,
Rapporteur,
Committee for the Study of Economic
and Monetary Union,
Banca d'Italia,
1-00184 Rome,
Via Nazionale 91,
Italy

Dear Dr. Padoa-Schioppa,

I am writing in response to the Chairman's invitation to submit written views on the last draft of Part III of the Report. In the light of the extensive discussions of the draft at our last meeting and the opportunities for further examination in March and April, I do not propose to deal here with specific drafting suggestions or with points of detail. I would, however, like to focus on some of the major issues that impinge on the shape of economic and monetary union, mainly those relating to the principles of parallelism and participation, which seem to me to have received insufficient attention in the draft.

I regard it as essential to adhere to the principle that there be parallel advances in interrelated areas. In particular, before

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the achievement of the final stage of economic and monetary union, all Community countries will need, through a continuous progression, to have reached a broadly similar level of economic development and to have achieved a high degree of convergence in fiscal, monetary and other economic policies. If this is not the case, disparities within the Community would cause persistent capital and labour flows from the less prosperous to the richer regions, creating both economic and political tensions that would put the whole process of realising EMU in jeopardy.

Giving practical expression to the principle of parallelism requires, in the first instance, that we should recognise and acknowledge the position from which we start. Significant progress has already been made towards coordination of monetary policies and the Skeleton of the Report proposes further detailed measures to progress such coordination by the strengthening of the role of the Committee of Governors. If monetary policy coordination is not to be overburdened, a prerequisite for further economic integration is that these advances be matched by convincing mechanisms for the coordination of other economic policies.

With regard to budgetary policies, there is a need to begin work immediately on improving the degree of coordination between member States. While evidence of progress on the monetary coordination front has been evident since 1979 and most recently with the Basle/Nyborg agreement, fiscal coordination has lagged far behind.

It is doubtful, therefore, if the measures outlined in stage 1 go far enough. To ensure effective commitment to EMU by the Governors

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Community institutions would, in stage 1, assume responsibility for coordinating budgetary policies and the adequacy of the mechanisms that would be employed to tackle emerging divergences of fundamentals is doubtful. These processes could be strengthened by bringing forward to stage 1 some elements of stage 2, particularly those relating to the adoption of medium-term guidelines for key financial targets and the coordination of budgetary policies. Moreover, the Skeleton of the Report, is not explicit on the nature of the CEPC or its level of responsibility, nor is it clear from whence the CEPC would derive its authority. It is vital for the effective coordination of budgetary policies that the CEPC should "have teeth" and be influential and effective at political level.

The principle of parallelism in economic and monetary union applies even more fundamentally to the issue of tackling regional imbalances. In the Report no new proposals are envisaged for stage 1, while none of the three stages leading to EMU explicitly acknowledges the essential role of Community regional policy. In stage 1 it is simply envisaged that the "Brussels package" for reforming and doubling the structural funds would be implemented in full. As my paper to the Committee on regional policy emphasised, such measures by themselves would not be sufficient to tackle the problem of regional disparities. The requirements of EMU go far beyond the 1992 programme in terms of the constraints which they place on policy autonomy in individual countries. As integration proceeds, policy autonomy would diminish, so that Community regional policy must play an increasingly active role if

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EMU is to be sustainable. Thus, long before reaching the later stages of EMU, adequate measures must already be in place to deal with the regional problem. In terms of the calendar outlined in the report, this would mean that from the beginning of stage 1 there should be an explicit and detailed regional dimension to all economic policies.

The principle of participation requires that not only should all member States reach a consensus on the final objectives of the Community but that, allowing for flexibility, a good deal of progress towards full participation be made by all member States by the end of each stage. In this regard, a significant step - and one that would not require a change in the Treaty - would be made towards EMU if by the end of stage 1 all member States fully participated in the exchange-rate mechanism of the EMS.

The Report requires that by stage 3 all member States would participate in a no-margins fixed exchange-rate system. As drafted, the manner in which this is to be brought about is not elaborated upon. The Report states that "all member countries [in a position to do so]" would participate in the ERM and that margins of fluctuation would be reduced. As I pointed out at the meeting, if the phrase in square brackets is retained in the final draft, a member State could conceivably move overnight from a floating to a totally fixed exchange-rate regime. This seems to me not merely imprudent but impracticable. It would seem more sensible to suggest that well before the final stage there should

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be an obligation on member States not already participating in the ERM to do so; this would enable a gradual movement towards a system of permanently fixed rates. It would also ensure that all member States took the prospects of EMU with the same seriousness.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'H. J. ...', written over a horizontal line.