

I. The present state of and perspectives for economic and monetary
integration in the Community

1. Introduction

1. This section will briefly recall the main features of the process of economic and monetary integration in Europe since the beginning of the 1970s. In particular, it will make reference to:

- the Werner Report, which presented a first attempt to define and set out a plan for the attainment of economic and monetary union;
- the perception by the mid-1970s that the process of integration had lost momentum; nonetheless a number of significant developments took place in the Community both in monetary areas (notably the establishment of the EMS) and in non-monetary fields;
- the new impetus to European integration in the mid-1980s, as reflected in the adoption of the internal market programme and the signing of the Single European Act;
- the fact that progress in one area has promoted advancement in other areas and that integration has now reached a stage where it is practically irreversible.

2. The section will conclude with a brief statement to the effect that the Community has proved able to overcome serious problems, has expanded as a result of the accession of new member countries and has revived the idea of economic and monetary union. In particular, it will stress that the Community is now on the move and that it has put its house in order by resolving the most urgent budgetary and policy issues.

2. The EMS and the adjustment of the European economy

3. In the monetary field a new phase in the process towards an economic and monetary union opened with the creation of the European Monetary System at the end of the 1970s. The progress made by the Community in the 1980s towards price stability, fiscal and structural adjustment, and greater economic integration owed much to the European Monetary System.

4. Within the framework of the EMS the Community has developed into a zone of increasing monetary stability ~~and open internal trade~~, in a period in which the world economy was shaken by wide exchange rate fluctuations and tensions in trade relationships. The acceptance of the exchange rate constraint has greatly assisted the participating countries in gearing their monetary policy towards the objective of price stability, thereby laying the foundations for both a converging price performance at a low rate of inflation and the achievement of a high degree of exchange rate stability. ~~Moreover, the greater priority given to a policy of monetary stability has contributed in many countries to a process of economic adjustment obtained through budgetary restraint and moderation in cost increases, and leading to an improvement in the overall performance of the economy. Finally, the reduced uncertainty about exchange rate developments and the fact that the parities of the participating currencies were not allowed to significantly depart from the fundamental economic conditions of the respective countries, created a condition favourable to the maintenance and strengthening of intra-European trade, even in a period of economic difficulties and severe unemployment.~~

The EMS has served as a focal point for improved monetary policy co-ordination and provided a basis for multilateral surveillance within the Community. Its success is in part attributable to the willingness of countries to opt for a strong currency policy stance, but also to the flexible and pragmatic way in which it has been managed. The System has evolved in response to changes in the economic and financial environment and on two occasions (Palermo 1986 and Basle-Nyborg 1987) its mechanism has been amended and improved.

5. The launching of the European Monetary System was accompanied by the creation and development of the ECU, which replaced the European unit

Can we say this? We are talking of member countries participating in the ERM.

and continued its process of financial and economic integration. This achievement was particularly remarkable

promoted &

helped to

→ Moreover

→ factors in

→ facilitated and at times

too favourable an assessment; there is very little quantitative convergence and, at present, growing external imbalances

of account. In setting up the EMS, the European Council declared in 1978 that "a European currency unit (ECU) will be at the centre of the EMS". Beyond being used as the denominator of the deposits with the EMCF obtained against gold and dollars conferred through the swaps mechanisms, and as a denominator of intra-EMS credit facilities, the "official" ECU has had a limited development and role in the EMS so far. The use of the ECU by private markets, however, has spread significantly, partly because of its intrinsic advantages and partly as a result of a perception that it could become the future currency of Europe.

The ECU has strongly developed as a financial instrument in private markets. In international banking it has become the sixth currency of denomination. The creation of an ECU clearing system two years ago, in which more than thirty commercial banks now participate, has contributed to the development and the liquidity of the market. The ECU also ranks fifth as a currency of denomination of international bond issues, with 6% of the market. A wide set of new instruments is now available for investors, both with short and long maturities. In the non-financial sphere the use of the ECU remains limited, ~~because of the scarcity of information and the difficulty to introduce innovations in the currency denomination of commercial transactions.~~ However, opinion polls, especially among firms, tend to show an increased interest in the potential uses of the ECU.

3. The Single European Act and the Internal Market Programme

6. On the economic side, a "relaunching" of Europe began in the mid-1980s supported by the success and ~~realization~~ of the EMS. The central element in this process was the proposal, made in May 1985 by the Commission, to realise the objective of a market without internal frontiers by 1992. The essence of the measures for the removal of physical, technical and tax barriers was set out in a White Paper, which specifies the programme, timetable and methods for creating a unified economic area in which persons, goods, services and capital will be able to move freely. This objective, together with the necessary institutional means, was embodied in December 1985 in the Single European Act which marked the first significant revision of the Treaty of Rome.

official
 a bit more detail on the use of the ECU ~~as~~ ?
~~official~~ e.g. its purpose as a settlement instrument

Can we really say that?

most important

for invoicing and settlement of commercial transactions.

covering at present perhaps only 12% of Community countries' external trade.

7. The Single Act signalled two significant changes in the Community's strategy to advance in the integration process. Firstly, it incorporated an institutional reform aimed at establishing a faster, more efficient and more democratic decision-making process which was considered to be indispensable for reaching the goal of a common unrestricted market. In particular, this reform extended the scope of qualified majority voting and thereby removed the constraints inherent in the permanent search for consensus which had hampered the decision-making process in the past, gave the European Parliament a greater role in the legislative process, and dramatically simplified the requirements of ~~the~~ ⁽ⁿ⁾ harmonisation of national law by limiting harmonisation to the essential standards and by systematic adoption of mutual recognition of national norms and regulations. Secondly, with the Single Act the member countries reaffirmed - and recognised in the context of the Treaty of Rome - the need to strengthen the Community's economic and social cohesion, to enhance the Community's monetary capacity in the perspective of economic and monetary union, to reinforce the Community's scientific and technological basis, to harmonise working conditions with respect to health and safety standards, to promote the dialogue between management and labour, and to initiate action to protect the environment.

8. Concerning the implementation of the single market programme, the progress made in the last three years (spring 1986 to spring 1989) is very significant and highlights a ~~marked~~ change of pace in approaching a unified market, as compared to the previous two decades.

→ marked

The effective realisation of the internal market ~~between now and~~ ^{by} 1993 involves the adoption of some 300 Directives. ~~It is not so much their number which is impressive, as the extremely short period of time available for their adoption, because~~ In view of the time required for them to be transposed into national legislation, the bulk of the Community's legislative work should be completed by the end of 1990. In three years the Commission has presented 90% of the proposals for the Directives concerned and the Council has adopted ~~about 50%~~ ^{W about one half} Whereas eighteen and sixteen years respectively were needed to ~~put through two Directives on the freedom of establishment of architects and pharmacists, two years were sufficient for the adoption of a general system for the mutual recognition of higher education diplomas.~~ Particular diligence is being displaced in dealing with

W about one half

the texts concerning the abolition of technical barriers. The speedy adoption of the Directives on the liberalisation of capital movements achieved in six months, and the freedom to provide insurance services for industrial risks (the adoption of which was made possible by the application of the principle of mutual recognition) has been particularly striking. Rapid and significant progress has been made with regard to machines, materials, foodstuffs, public works and supply contracts, sea, air and road transport, and financial services. Progress is slower as regards the abolition of tax barriers and physical barriers. The speedy application of Community law connected with the internal market will be served by greater delegation of implementing powers to the Commission; by various measures to ensure the transparency, efficiency and legal certainty of the procedures governing the conduct of the Community's competition policy, whether in the field of merger control or state aids; and by the forthcoming establishment, alongside the European Court of Justice, of a court of first instance, in particular specialising in competition questions.

Concerning the Community policies accompanying the creation of the single market, a package of measures was approved by the European Council in February 1988:

- the reform of the Common Agricultural Policy has been continued to take account of new production and trade conditions;
- substantial resources have been allocated to the Community's structural policies (in particular the doubling of the structural funds by 1993 and the adoption of a framework programme for research and technological co-operation). Their objectives have been built around a few major priorities: to strengthen the scientific and technological bases of European industry, with a view to developing its international competitiveness; to take on the challenge of the economic and social cohesion of the Community by achieving growth and adaptation in regional economies showing structural backwardness, by supporting the conversion of declining industrial regions, by combating long-term unemployment, by integrating young people into employment, and by encouraging rural development; to support the realisation of large infrastructures of European interest and to

The most prominent - and certainly one of the most significant - examples is

which will come into force... and will have far-reaching economic and financial implications.

Another important step in the direction of greater financial integration was the adoption of the directive establishing

the liberalisation of trade in ? or what does that mean?

it separate para? Introductory sentence perhaps like that. In parallel with the implementation of the internal market programme, the a number of practical measures was... ?

this is much too detailed

promote a European approach to environmental problems. New thinking has been applied to the methods of implementing these structural policies: the concentration of resources, the selection of actions which are sure to have a strong multiplier effect, the substitution of the concept of programmes for that of projects, and the introduction of a partnership between the Community and the beneficiaries;

- finally, it should be noted that the European Investment Bank will also have to contribute to the objective of economic and social cohesion, in proportion to its substantial resources.

At the same time, the Community has adopted a new financial regime which provides it with a system of own resources which is adequate, stable and guaranteed, thus ensuring the continuity of Community activities. It also establishes the procedure for greater budgetary discipline on the basis, firstly, of an institutional agreement between Parliament, Council and Commission on the ceiling for budget resources year by year from now until 1992; secondly, of a multi-annual approach to the planning of expenditure; and finally, the strengthening of the principle of budget "annuality" in the execution of the budget.

4. Perspectives, opportunities and problems

9. The European Council, meeting in Rhodes in December 1988, noted that "at the halfway stage towards the deadline of December 1992, half of the legislative programme necessary for the establishment of the large market is already nearly complete" and underlined "the irreversible nature of the movement towards a Europe without internal frontiers".

Among economic agents, the objective of a large market without internal frontiers enjoys broad support, ~~emanating to a significant extent also from the~~ dynamic forces ~~that the objective of 1992 has crossed~~ at every decision-making level. In the private sector the anticipation effects are clearly reflected in the investment strategies of European firms and the unprecedented number of mergers foreshadowing the intensification of industrial co-operation. The prospects of a single market, the credibility of the member countries' desire to move towards a highly integrated Community and the enhancement of the decision-making capacity of Community

and has generated

bodies are having a strong impact on the behaviour of market participants in the Community.

10. The advantages deriving from the completion of the internal market are, in terms of economic welfare and greater freedom for the European people, deep and widespread because of the very deep structural change in the European economy required and promoted by the establishment of the single market. Such change will not only involve regulatory and other policy aspects for which a competence will have to be established at the Community level, it will also involve the conditions under which policy functions that remain a preserve of national authorities will be exerted. This is so because the degree of economic interdependence among member countries will be significantly strengthened by the single market, thereby enhancing the repercussions that each economy will receive from impulses originated in other member states. In the economic field, the dismantlement of all physical, regulatory and tax barriers in the exchange of goods and services will increase and accelerate the cross-frontier effects of cost and budgetary developments originating in each member state. In the financial and monetary field, this effect is going to be even stronger, following the complete liberalisation of capital movements that will become effective in most member countries by mid-1990.

11. The maximum benefit from the creation of the single market can be brought about only through more stable exchange rates and closer co-ordination of economic and monetary policies. An efficient allocation of economic resources in a wide, integrated space will only be possible in a framework of exchange rate stability. If the flexibility and scope for parity adjustments offered by the present EMS arrangements were to be intensively used to cope with pressures on exchange rates originating from financial disturbances, real exchange rates would depart from economic fundamental conditions, and investment and consumption decisions by economic agents would be made inefficient by such misalignments. In order to avoid such developments a close degree of macro-economic policy and monetary policy co-ordination is indispensable, as well as the enhancement of the resilience of the EMS. A lack of co-ordination would inevitably lead, sooner or later, to mutually inconsistent policies being conducted in different countries. Such inconsistency would eventually produce imbalances

price +
stability
we have
to say
real ex.
rate
stability

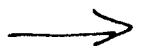
lejos
inside
down!
1?

Creation of internal market involves profound structural changes:

- in private markets: greater economic freedom + wider choice; more efficient use and allocation of resources through increased competition, exploitation of economies of scale, comparative advantages, reduced costs from streamlining "red tape"
- at the official level: a new regulatory framework involving both the Community and national authorities

Consequences of internal market: growing interdependence, separate national authorities face one market; therefore increasing constraints on national policy-making

Beneficial effects will only be reaped, if structural changes are matched by closer policy coordination; where are the limits under present arrangements? This point should fill a separate paragraph!



in Community exchanges of goods and services and would, in turn, feed the illusion in some political quarters that the tensions could be relieved by protecting some sectors of the economy through recurrent recourse to safeguard clauses and/or ~~rate~~ exchange rate change, rather than by adopting the appropriate structural or macro-economic policies. This would induce a slowing-down in the process of opening our economies or even a rethinking of some of the steps already taken. Economic agents would be inclined to take full account of the single market in their economic decisions only if they were strongly convinced that the single market is going to last. The perception that the move towards a single market is, indeed, "irreversible" would not be solid without the support of a significant enhancement in the degree of policy co-ordination.

→ competitive
contradicts para 9!

12. If the conditions exist in which the Single Act can succeed, its implementation will produce additional growth, intra-Community trade and employment for the European Community. The studies evaluating the potential economic effects of completing the internal market have estimated that the additional growth could be equivalent to between 4.5 and 7% of Community GNP and that five million additional jobs could be created.

? internal market programme be implemented?
→ to para 10

The European area will then constitute an "optimum monetary area" in which exchange rate stability will be in the interests of each of the parties.

On these bases, and provided that the conditions for convergence exist and without wishing to prejudge the timing, transition to a situation of economic and monetary union would add appreciably to the level and distribution of prosperity in the Community. The risks associated with the elimination of the exchange rate instrument as a means of adjustment will be examined below, but they would be alleviated by the development of common policies and the increased co-ordination of economic policies. On the other hand, the strategies and the behaviour of those involved in economic activity would be served by the elimination of exchange rate uncertainties, the reduction of transaction costs and, perhaps above all, by the perfect transparency of prices which, in itself, should go a long way towards accentuating the gains to be achieved from the internal market.

more than expected the gains internal market programme? If so, we have to explain why.

The common policies, regional and sectoral, of economic union would have powerful redistributive effects, but they would also be conducive to a better allocation of resources by correcting, at Community

Following a para on the limits of policy coordination under present arrangements, we might perhaps argue that nonetheless many of the measures required for a smooth working of the internal market take us closer to EMU.

For that to be reached, however, a fundamental change in macro-economic management will be required (both in monetary and fiscal areas)

Then we could discuss the value added of EMU.

level, certain imperfections in the market, for example in the areas of research and development, infrastructure and energy, or the credit rating of public borrowers.

The increased co-ordination of economic policies would be necessary in order to ensure the stability of the system; it would also be beneficial for the member states insofar as it ensured that the increased economic interdependence and the external effects of national economic policies were systematically taken into account and that the reciprocal room for manoeuvre which could be created by a co-operative strategy was used effectively. All in all, therefore, new opportunities would be created for the Community in terms of growth, competitiveness, employment and cohesion.

In the interplay of international concertation European economic and monetary union will also bring a new actor onto the scene whose importance will give it a decisive influence on the management of the world economy and the international monetary system. Exercised in a responsible way, the enhanced Europe's capacity for negotiation and action can make a powerful contribution to the stabilisation and therefore to the growth of the world economy, and this is bound to have induced beneficial effects for growth in Europe.

13. Economic and monetary union has been set as a goal by the Community since the late 1960s. The single market, by itself, does not require the establishment of an economic and monetary union. It requires, however, a significant increase in the degree of economic policy co-operation even in areas that are not, as such, part of the single market programme. Such an increase represents a significant progress in the path leading to an economic and monetary union. This is the reason why the European Council in Hannover has decided to consider again the problem of an economic and monetary union and the steps leading to it. These are the subject matters of Parts II and III of this Report.

What does para 12 really
deal with? internal market
or EMU?

(Tommaso,

Sorry, as re-reading my
comments I am afraid that
I have not been very helpful;
I think we should have a
somewhat longer discussion
between us on the structure
and content - as well as
the reasoning - in that
concern final section of Part I.

Best regards,

John

2. ERM (Codebook)

- no excessive ^{exchange} volatility leads to involvement of central banks
- change in central rates = hardly multilateral decision
+ time
= frequency / adjustment
= complied with adjustment mechanism
- ex. rate used to impose competition pressure, not fully compensated for inflation differentials

growing degree of convergence in monetary performance;

- leadership of BDe, DM = anchor
- Germany do not participate in ERM

Discussion

- acceptance that inflation not should converge on price stability
- contribution of ERM to see a stability advanced communication with a gradual relaxation of central banks
- no yet a satisfactory degree of convergence in other areas fiscal, growth

discussion,

ERM has been flexible, pragmatic arrangements often preferred to strict or explicit rules. ERM package of 1971 Bittlinghoff 1984

EMS (Commission)

- distribution no longer an early option; adjustment in practice accompanied by domestic adjustment measures
- ex. r. used to meet downward pressure on inflation
- mutual decision process in independent, by common accord joint decision, by unanimity
- although a monetary management, it imposes a consistent necessity more general accompanying measures, thus promoting greater ec. convergence
- success of EMS depends critically on an underlying policy consensus, i.e. how to handle the loss of sovereignty at the national level implied by monetary + ec. integration
but only discussion, no formulation of a common position or joint decision
-
- governments have committed themselves to least currency option compatible of EMS but gradual with ec. growth + stability
- EMS has succeeded in promoting closer monetary cooperation; increased institutional role precedence over ex. r. adjustment
- EMS, by inhibiting ex. r. has contributed to ec. integration and laid foundations for integrated market
- rules and procedures which caused to meet objections, but flexible enough to change implications + strategies in the face of changing ^{monetary} circumstances; behaviour in markets has changed

When does the internal market programme take us directly:

- establishment of a unified market
- transfer of some regulatory power to the Commission
- introduction of or strengthening of common policies

indirectly:

- close monetary policy coordination through central bank cooperation

gains:

- wider choice, freedom
- economies of scale, more efficient production costs
- cost saving from elimination of border controls + recognition of standards
- ∑ impact on resource allocation, more growth, employment and economic welfare

challenges:

- growing independence of economies must be matched by corresponding policy adjustments
- faster progress on regional disparities
- short-term speculative capital movements, pressures in the EMS

Conclusion: The changes should not be unbalanced, their impact could undermine the expected gains from the market. Further many member countries

Convergence: a closer coordination of policies
greater emphasis on common policies

The successful re-emergence of the internal market
in fact leads us incrementally further on the road
to EMU

Why EMU:

- apart from political motives, the single market faced by separate national decision-making represents a persistent and delicate balance; a constant testing of good will on the part of the authorities
- for the progress in integration does not only satisfy the aims of the market programme, it also provides an additional value-added

Reasons for additional goals:

- the internal market cannot develop full potential if monetary stability, i.e. price & w.a. stability, cannot be credibly insured
- permanent stability can only be achieved in the context of a monetary union

Cost and benefits of a monetary union

Cost → loss of ex. rate instrument, which is a
convenient instrument to bring about an
adjustment in real wages and thereby helps
to contain undesirable output and
employment effects; also an instrument
to reduce the harmonization of price developments

benefits → ~~reduction~~ elimination of ex. r. uncertainty
as far as the Community trade is concerned
reduction in transaction cost
greater harmonization of prices

internal rate differences would disappear

But movement to EMU would necessitate parallel movement in
economic areas

- in order to safeguard the EMU
- in order to enable the pursuit of an appropriate

macro-econ. policy

↳ this, in itself, would have best/worst gains
(coordination agreement)

- other common policies may spread the benefits and produce
best/worst gains (externalities agreement)