Niels Thygesen 12th April 1989

Suggested amendments to Part III

Add after present para. 46:

47. Indivisibility and gradualism. Gradual progress in a step-by-step approach must not produce ambiguity as to who - a national government or the Community, which organ or institution - has the ultimate responsibility for particular policy decisions and their execution. Any such ambiguity would create a risk of policy conflict and of market uncertainty. Whereas in the budgetary field policy functions can be, and are, shared between different levels of government in all constitutional systems, monetary authority is not easily divisible.

Authority will not be divided once exchange rates have been irrevocably locked because - as explained in Part II of this Report - a common monetary policy will then be required and will have to be formulated collectively in the framework of the European System of Central Banks. However, as long as national governments retain the use of realignments of the central rate for their currencies as they do in the present EMS and as they would do in the stages prior to the irrevocable locking of parities, ultimate monetary responsibility rests with national governments and central banks, though in practice that responsibility is severely circumscribed by the need to obtain the agreement of partner countries to a realignment and by the need to manage its instruments in a co-operative rather than a competitive manner.

For the stages prior to the locking of exchange rates the challenge is to develop rules and procedures which make possible the shifting of responsibility for some monetary instruments to the Community level while leaving that for others to individual governments (realignments) and national central banks (short-term interest rates). The description of the pre-monetary union stages below takes up illustrative examples of how experience might be gained in the joint management of some instruments, viz. foreign exchange interventions in third currencies and reserve requirements.

48. The Committee, having in mind the above principles governing a step-by-step approach, considered that concrete steps in any move towards EMU might be along the following lines:

Stage 1 (closer co-operation and co-ordination)

- completion of the internal market, including full liberalisation of capital movements;
- closer policy co-ordination, including increasing willingness to consult ex ante;
- further enhancement, as necessary, of the effective working of the ERM; all member states to bring their currencies within the narrow margins of the ERM;
- development of existing institutions to promote the greater degree of monetary and economic policy co-ordination.

Stage 2 (soft union)

- joint formulation of monetary policy and more formal centralisation of co-ordination of fiscal policy; outcome of co-ordination process increasingly binding;
- greater exchange rate stability within the ERM (and, possibly, narrower ERM margins) but central rates still adjustable if necessary; joint formulation and co-ordinated execution of exchange rate policy in relation to third countries;
- new institution(s) established in embryo and given limited functions.

Stage 3 (hard union)

- fixed exchange rates, moving as soon as practicable to a single currency;

- single monetary policy; single exchange rate policy (in relation to third countries' currencies);
- acceptance of agreed constraints to fiscal policy as being binding;
- new institutions fully in place.

These stages are discussed in paras. xx-yy below.