Dear Joly,

Please find attached re-drafts of paragraphs 33 and 34 as well as the section on the ecu. In addtion we have another query.

As Tommaso has mentioned to you on the telephone, we will need some clarification on the name of the monetary institution in a European economic and monetary union. The Committee has so far expressed the wish to call the institution the "European System of Central Banks", which, in addition to national central banks, would consist of the ESCB Council as the decision-making body and the ESCB Board and staff making up the central institution. Introducing a new acronym for the central institution alone would be somewhat confusing. An alternative solution might be to drop completely the name "European System of Central Banks" and to adopt, as an analogy to the US system, the name "European Federal Reserve System" (EFRS), which, apart from the national central banks, would be made up of the EFRS Council as the decision-making body and the European Federal Reserve Board, consisting of the four Board members and the staff. Without a clear instruction from M. Delors we would not introduce a new name at this moment. However, the Chairman might wish to make the suggestion at the March meeting to adopt the term EFRS, which we would prefer.

Best regards,

Gunter and Tommaso

conditions that would prompt the recipient to intensify its adjustment efforts.

33. Macro-economic developments are the third area in which action would be necessary in order to have a viable economic and monetary union and to draw from it maximum benefits. This will require an appropriate definition of the role of the Community in the co-ordination of economic policies.

The major developments on which macro-economic conditions depend would continue to be determined by factors and decisions operating at the national level. This would apply not only to wage negotiations and other economic behaviour in the fields of production, savings and investment, but also to the action of public authorities in the economic and social sphere. Aside from the system of binding rules governing the size and the financing of national budget deficits, decisions on the main components of public policy in such areas as internal and external security, justice, social security, education, and hence on the level and composition of government spending as well as many revenue measures would remain the preserve of member states even at the final stage of economic and monetary union. Only if the provision of major public goods constituting the bulk of public sector activity were to a large extent attributed to the Community level would the Community budget be significantly enlarged.

However, an economic and monetary union could only operate on the basis of mutually consistent and sound behaviour by governments, unions and other economic agents in all member countries. In particular, unco-ordinated and divergent national budgetary policies would not only undermine monetary stability, but would also generate imbalances in the real and financial sectors of the Community and render it impossible to pursue appropriate macro-economic policies for the Community as a whole. Similarly, strong divergences in wage levels not justified by different trends in productivity would produce economic tensions and pressures for monetary expansion.

To some extent market forces would exert a disciplinary influence because financial markets, consumers and investors would respond to differences in macro-economic developments in individual countries and regions, assess the budgetary and financial position of different countries, penalise deviations from commonly agreed fiscal guidelines or wage settlements, and thus would exert pressure for sounder policies. However, experience suggests that market perceptions do not necessarily provide strong and compelling signals and that access to a large capital market may for some time facilitate the financing of economic imbalances. Rather than leading to a gradual adaptation of borrowing costs, market views about the creditworthiness of official borrowers tend to change abruptly and result in the closure of access to market financing. The constraints imposed by market forces might either be too slow and weak or too sudden and disruptive. This is why countries will have to accept that sharing a common market and a single currency area imposes policy constraints.

In the general macro-economic field, an overall assessment of the short-term and medium-term economic developments of the Community should be agreed periodically and constitute the framework for a better co-ordination of national economic policies. The Community should be in the condition to monitor its overall economic situation, to assess the consistency of developments in individual countries with regard to common objectives and to formulate guidelines for policy.

In the wage and industrial relations field, the autonomous negotiating process of social partners should be preserved and strengthened in view of the role it plays in improving the prospects for growth and employment. To this end efforts would have to be made to convince European management and labour of the advantages of gearing wage policies largely to improvements in productivity and thus to contribute or accept a uniform minimal rate of price increase at the Community level. Governments on their behalf should strengthen tendencies towards reducing or completely eliminating direct intervention into the wage and price formation process.

In the budgetary field, particular arrangements are necessary. Such arrangements should, firstly, impose effective and binding limits on budget deficits that could be incurred by individual member countries of the Community, although in setting these limits the situation of each member country might have to be taken into consideration. Secondly, the arrangements would have to include (in accordance with the criteria laid down for a European System of Central Banks) strict limits - both in size and duration - on the maximum permissible access to central bank credit, as well as on borrowing in non-Community currencies. Thirdly, the arrangements should enable the Community to conduct a coherent mix of fiscal and monetary policies, i.e. to dispose of a system of rules that could be applied with a view to determining the aggregate balance on national budgetary positions, including that of the Community.

34. In summary, the establishment of an economic union would require:

- the creation of an internal market without physical, technical or fiscal frontiers, supplemented by a competition policy which effectively removes distortions in competition;
- a system of policies to stimulate regional and structural developments through multi-annual investment programmes, which would help regions with lower productivity to catch up with the more developed parts of the Community;
- common policies in infrastructure, research and technological development, and environment, which would help to exploit the full potential of the single market and complement its role in the allocation of resources;
- a consideration of the social dimension of the European Community;
- a framework for monitoring and co-ordinating general short-term and medium-term economic developments in the Community with a view to attaining non-inflationary, balanced economic growth;
- effective an binding co-ordination procedures, which would enable the Community to determine its macro-fiscal policy stance policy, to set maximum possible deficits for national budgets taking into consideration the situation of each member country, and limits on both monetary financing and borrowing in third currencies.

4. Institutional arrangements

35. Management of the economic and monetary union therefore would call for an institutional framework which would allow policy to be decided and executed at the Community level in those economic areas that were of direct relevance for the functioning of the union. The institutional framework would have to guarantee efficient economic management, properly embedded in the democratic process. The creation of a monetary union would necessitate the setting-up of a new monetary institution, placed in the

3. <u>The ecu</u>

48. The Committee examined various aspects of the role that the ecu could be expected to play in the process of economic and monetary integration in Europe. The Committee is of the view that the ecu should develop into the future single currency of the Community. The realisation of this objective would take time and it should not be forced by issuing ecus as an independent currency in addition to the existing national currencies. In order to be able to develop into the future single currency, it would be essential that market participants become better acquainted with the ecu and that, as a result of a market-determined process, the use of the ecu in financial and commercial transactions would spread throughout the Community. As far as the official ecu was concerned, the Committee felt that, apart from increasing the operations in official ecus within the EMS and enlarging the group of third holders, the official ecu could possibly be employed as an instrument of monetary policy co-ordination at an advanced stage of integration. As far as the private ecu was concerned, a number of promotional measures could be envisaged which would encourage its use in private markets.

The Committee's conclusions and proposals regarding this important subject are to be found in several parts of the Report. They concern both the final phase and the intermediate stages of the economic and monetary union. For expositional convenience the conclusions are summarised here in four propositions.

49. Firstly, the Committee was of the opinion that the ecu should develop into <u>the future currency of the Community</u>. Although a monetary union does not necessarily imply a single currency, (but for) economic, political and psychological reasons suggest that a single currency would be a natural and desirable feature of a monetary union. A declaration that the ecu should develop into the future currency of the Community is desirable. It would assure private agents that there would be no discontinuity between the present ecu and the single currency of the union and that ecu obligations would be payable at face value in ecu if the transition to the single currency had been made at the time of the maturity of the contract.

50. Secondly, the Committee considered the possibility of adopting a parallel currency strategy as a way to force the pace of the monetary union process. According to this approach the definition of the ecu as a basket of currencies would be abandoned at an early stage and the new fully-fledged currency, called ecu, would be created autonomously and issued in addition to the existing Community currencies. The new ecu would be a parallel currency in the sense that it circulated alongside national currencies and competed with them. The proponents of this strategy maintain that the gradual crowding-out of national currencies by the ecu would allow to circumvent the institutional and economic difficulties of establishing a monetary union. The Committee felt that this strategy is not to be recommended for two main reasons. Firstly, an additional source of money creation without a precise linkage to economic activity could jeopardise price stability. Secondly, the addition of a new currency, subject to an independent monetary policy, would further complicate the already difficult endeavour of co-ordinating different national monetary policies.

51. Thirdly, the Committee examined ways for increasing the use of the official ecu. One possibility in this direction was to employ the official ecu as an instrument in the conduct of a common monetary policy. Under such a scheme the official ecu would serve as a reserve instrument, establishing a link between each national central bank and the central institution of the European System of Central Banks. Before the final stage, the ecu would circulate only among central banks and provide a basis for an operational framework for a common monetary policy that would replace voluntary co-ordination. The Committee felt that such a proposal was one possible way of preparing the ground for a common monetary policy in the course of the second stage.

52. Fourthly, the Committee agreed that a number of measures could promote the voluntary use of the ecu by the private sector as a unit of account and as a means of settlement. In order to avoid undesirable distortions in the financial markets there should be no official discrimination in favour of the ecu; there should, however, be both direct and indirect encouragement. Direct encouragement should aim at increasing the critical mass of transactions in ecu, for example, by stepping up borrowing in ecus by public authorities, increasing the use of the ecu in

official transactions inside and, whenever possible, outside the Community, utilising the ecu more extensively in exchange market interventions, and providing greater support to the ecu clearing system. One of the most important measures to promote indirectly the use of the ecu would be the declaration that the ecu should develop into the future single currency of the Community. This should provide a clear signal to the private sector to familiarise itself with the ecu. An additional indirect incentive would be the removal of all administrative restrictions on the use of the ecu as a means of settlement and for accounting purposes. In particular, after having been granted the status of a foreign currency, consideration could be given to putting in each member country the ecu on an equal footing with the national currency. Moreover, evidence of a greater use of the official ecu within the EMS and a growing number of official institutions outside the Community holding such ecus could be another form of indirect encouragement.