COMMITTEE FOR THE STUDY OF ECONOMIC AND MONETARY UNION

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II. How to define the final stage of economic and monetary union

1. Introduction

1. Economic and monetary union in Europe would imply complete freedom of movement for persons, goods, services and capital, as well as irrevocably fixed exchange rates between national currencies or a single currency. This, in turn, would presuppose a high degree of integration and require a common monetary policy and consistent economic policies geared towards price stability, balanced growth and converging standards of living, high employment and external equilibrium. Economic and monetary union would represent the final result of the process of progressive economic integration in Europe.

2. The EC Treaties, as amended by the Single European Act, would provide the legal foundation for many of the necessary steps towards economic integration. However, the existing Treaties do not suffice for the creation of an economic and monetary union. The realisation of this objective would call for new arrangements which could only be established on the basis of a new Treaty and consequent changes in national legislations. For this reason the union would have to be embodied in a Treaty which clearly lays down the basic functional and institutional arrangements, as well as provisions governing their step-by-step implementation.

3. Even with a single market, a unified monetary system and an institutional and functional framework for economic management, the Community would continue to consist of independent nations with differing economic characteristics, traditions, social customs and languages. The existence and preservation of this plurality and diversified structure

would necessitate that a certain degree of autonomy in economic decision-making continued to rest with individual member countries and that a balance would be struck between national and Community competences. In fact, there is no precedent in modern history for the creation of an economic and monetary union in the absence of, or before reaching, political union. For this reason it is not possible simply to model an economic and monetary union for the Community on the example of existing federal states; it is necessary to develop an innovative and unique approach.

An essential element of any approach consistent with the historical and economic conditions in member countries would be the distribution of economic policy responsibilities within the Community in strict conformity with the constitutional "principle of subsidiarity". According to this principle, the functions of higher levels of government should be as limited as possible and should be subsidiary to those of lower levels. Thus, the attribution of competences to the Community would have to be confined to those areas in which collective decision-making were necessary, whereas all policy functions which could be carried out at national (or local) levels without adverse repercussions on the cohesion and functioning of the economic and monetary union would have to remain within the competence of the member countries.

With due regard to the principle of subsidiarity and taking into account what is already provided for in the EC Treaties, the need for policy decisions to be taken at the Community level would arise primarily in the field of macro-economic management. A monetary union would require a single monetary policy and the responsibility for the formulation of this policy would consequently have to be vested in one decision-making body. In the field of fiscal policy a wide range of budgetary decisions would be left to national authorities, but their decision-making would have to be governed by a framework of binding rules which would enable the Community to determine an overall fiscal policy stance, avoid major differences in public sector borrowing requirements between individual member countries and follow common policies with regard to the financing of budget deficits.

4. A step-by-step approach to implementing an economic and monetary union can be set out only if there is a clear understanding of this final objective, of its implications for the working of the economy and economic

policy decisions, and of the principal elements that have to be in place for its successful and durable functioning. Economic union and monetary union are closely intertwined, form two integral parts of a single whole and would therefore have to be implemented in parallel. It is for reasons of expositional clarity that the following sections look separately at the principal features defining an economic and a monetary union. This description begins with the concept of a monetary union, chiefly because an economic union can be circumscribed more clearly and specifically once the main elements of a monetary union have been identified.

2. The principal features of monetary union

5. A monetary union describes a single currency area in which policies are managed jointly by individual countries with a view to attaining common macro-economic objectives. As already stated in the 1970 Werner Report, there are three necessary conditions for a monetary union:

- the assurance of total and irreversible convertibility of currencies;
- the complete liberalisation of capital transactions and full integration of banking and other financial markets; and
- the elimination of margins of fluctuation and the irrevocable locking of exchange rate parities.

The first two of these requirements - the convertibility of Community currencies and the creation of a free and fully integrated financial market - have already been met, or will be with the completion of the internal market programme. The basic conditions for a monetary union would, however, be accomplished only when the decisive step were taken to lock irrevocably the exchange rates between Community currencies. This would be the single most important step towards creating a situation in which all currencies could be used equally to set prices, make payments and denominate debts or credits.

As a result of the permanent fixing of exchange rates national currencies would become increasingly closer substitutes and their interest rates would tend to converge. However, the pace with which these developments took place would depend critically on the extent to which firms, households, labour unions and other economic agents were convinced that the decision to lock exchange rates would not be reversed. Initially, the continuing existence of national currencies might leave doubts about the commitment to unchangeable exchange rate parities and could engender market perceptions of differences between individual currencies' quality and standing. Both coherent monetary management and convincing evidence of an effective co-ordination of non-monetary policies would be crucial in dispelling such doubts over time.

6. The three above-mentioned requirements are necessary for the establishment of a single currency area, but their implementation would not necessarily mark the end of the process of monetary unification in the Community. At a later stage the adoption of a single currency, while in principle not strictly necessary for the creation of a monetary union, might be seen - for economic as well as psychological and political reasons - as a natural and desirable further development of the monetary union. A single currency would clearly demonstrate the irreversibility of the move to monetary union, greatly facilitate the monetary management of the Community and gain a much higher weight in international markets than any individual Community currency. In this connection, it would be desirable to endorse the idea that the ECU should develop into the future currency of the Community and that an official declaration to this effect should be made at the time of the decision to draw up a new Treaty. This declaration would imply that there should be no discontinuity between the present ECU and the future single currency, i.e. that any debt contracted in ECU before the introduction of the single currency would be payable at face value in ECU if, at maturity, the transition to the single currency had been made. While the Treaty should allow for an appropriate period of transition, this would mean that ultimately the ECU would replace existing national currencies and serve as a means of payment, unit of account and store of value for all residents of the Community. The introduction of a single currency would, however, be possible only some time after exchange rates had been locked, when economic agents had become sufficiently acquainted with the ECU and when its use in commercial and financial transactions had spread.

7. The establishment of a monetary union would have far-reaching implications for the formulation and execution of monetary policy in the Community. Once permanently fixed exchange rates had been adopted, but national currencies continued to exist in an environment of free and fully integrated capital and money markets there would be the need for a single monetary policy carried out through new operational procedures and not simply through the co-ordination of as many national monetary policies as there were currencies participating in the union. This, in turn, would require the attribution of the responsibility for monetary policy to a new institution, the European System of Central Banks, (the principal features of which are outlined in Section 4), which would not only form the basis for centralised and collective decisions on the expansion of money and credit in the Community, but would also possess the necessary financial attributes (i.e. its own balance sheet) and the regulatory powers to enforce implementation of the chosen policy. In designing the necessary operational framework particular attention would thus have to be given to two essential requirements. Firstly, an agreement would have to be reached on an unambiguous procedure for setting specific objectives of the Community's aggregate monetary policy; and secondly, instruments would have to be developed with which the compliance of national monetary authorities with the commonly taken decision could be ensured.

This shift from national monetary policies to a single monetary policy would be an inescapable consequence of entering a monetary union and would mark one of the principal institutional changes required by economic and monetary union. In practice, however, the incision would not be so deep but rather would represent the completion of a progressively intensified co-ordination of national monetary policies, which had in many respects already foreshadowed the move to a single monetary policy in the Community. Even prior to the decision to fix exchange rates permanently, the liberalisation of capital movements and financial market integration will create a situation in which the co-ordination of monetary policy will strengthen progressively. Once every banking institution in the Community is free to accept deposits from and grant loans to any customer in the Community and in any of the national currencies, the large degree of territorial coincidence between the national central banks' area of jurisdiction, the area in which their currency is used and the area in which "their" banking system operates will be lost and the effectiveness of national monetary policies will become increasingly dependent upon co-operation among central banks. Indeed, the growing co-ordination of monetary policies will make a positive contribution to financial market integration and will help central banks to gain the experience that is necessary for moving to a single monetary policy.

8. As has been pointed out in Part I of this Report, the decision to lock exchange rate parities between national currencies irrevocably would have <u>profound effects</u> on the functioning and the performance of the economy of the Community.

A monetary union would remove exchange rate uncertainties and lower transactions costs, eliminate the possibility of movements of exchange rates unwarranted by fundamental factors, contribute to the evolution of a more homogeneous economic structure in the Community and reduce the susceptibility of the Community to external shocks.

At the same time, with parities irrevocably fixed, foreign exchange markets would cease to provide a source of pressure for policy corrections when economic disequilibria developed and persisted. Moreover, while the exchange rate could no longer serve as an instrument for adjusting economic imbalances among member countries, there would still be the possibility of divergences between the supply of and demand for economic resources in individual Community countries. However, the statistical measurement and the economic interpretation of such imbalances might become more difficult and balance-of-payments disequilibria would essentially reflect regional imbalances in a fully integrated market. As a consequence, balance-of-payments figures, which are currently a highly visible and sensitive indicator of economic disequilibria, would no longer play such a significant role as guidepost for policy-making.

However, the balance between the economic benefits and costs of exchange rate fixity would become more and more favourable as the Community developed into an economic and monetary union. In order to tilt the balance in this direction it would be essential that the move towards monetary union were coupled with measures designed to strengthen the mobility of factors of production and a close co-ordination of economic policies.

9. In <u>summary</u>, the realisation of a monetary union would mean that in a situation of free capital movements and full financial integration the

exchange rates between Community currencies would be irreversibly fixed. This would create a monetary union in which, at least initially, all national currencies circulated freely, although they might eventually be replaced by the ECU as the sole Community currency. The transition from a situation of fixed but adjustable exchange rates to a system of permanently locked parities would imply a fundamental change in the economic as well as the monetary management of the Community. National monetary policies would have to give way to a single monetary policy for the Community as a whole, formulated and executed jointly in the context of a European System of Central Banks. At the same time, a single currency area would imply the abandonment of the exchange rate as an instrument of adjustment of imbalances among Community countries and would therefore require, in parallel to the process of monetary integration, measures to co-ordinate effectively policies in non-monetary areas.

3. The principal features of economic union

10. Economic union combines the characteristics of an unrestricted common market with a set of rules which are indispensable for its proper working. In this sense economic union can be described by four basic elements:

- the single market within which persons, goods, services and capital can move freely;
- competition policy and other measures aimed at strengthening market mechanisms;
- common policies aimed at structural and regional development; and
- binding rules for budgetary policies.

In identifying the content and limits of specific rules defining the policy framework of an economic union, the Community should be guided by two considerations.

Firstly, the economic union should be inspired by the same "market economy" principles that constitute the foundation of the economic order of its member countries. Differences in policy choices may exist between member countries or - within the same country - in different periods. However, beyond such differences, a distinctive common feature of economic systems in Europe is the combination of a large degree of freedom for market behaviour and private economic initiative with public intervention in the provision of certain social services and public goods. Within this broad conception, the scope for attributing to the Community economic functions that are at present exercised at national levels should be limited by adherence to the principle of subsidiarity.

Secondly, an appropriate balance between the economic and the monetary components should be ensured for the union to be viable. This would be essential because of the close interactions between economic and monetary developments and policies. A coherent set of economic policies at the Community and national levels would be necessary to maintain permanently fixed exchange rates between Community currencies; and conversely, a common monetary policy in support of a single currency area would be necessary for the Community to develop into an economic union.

The measures aimed at creating the single market are to a large extent envisaged in the EC Treaty and the Single Act. With their implementation, by 1992, all barriers which tend to separate markets along national borders will be eliminated. In particular, all technical and regulatory obstacles will be removed, norms will be harmonised or mutually recognised, and certain common minimum standards governing social policy and consumer and environmental protection will be agreed. Moreover, national tax treatment will be harmonised to such an extent that it would not be a source of severe distortion in the competitiveness of industries operating in different countries of the Community.

The creation of a single market will impart strong impulses to economic growth and increase economic welfare through both a further specialisation in line with countries' and regions' comparative advantages and the exploitation of economies of scale in production, research and marketing. These gains will materialise as the residents in the enlarged market without internal frontiers respond to price, wage and interest rate movements, which, transmitted throughout the Community, will provide important incentives for a more efficient use of economic resources. There is no doubt that this process will stimulate economic activity and employment in the Community as a whole, and will generate greater economic freedom and increased trade in goods and services.

11. As has been discussed in Part I the single market in combination with irrevocably fixed exchange rates or a single currency would benefit from a monetary environment of greater certainty that would further enhance the advantages of an enlarged economic space. However, as previous historical experience has shown - it would also encounter certain economic constraints, due to the fact that exchange rate realignment would no longer be available as an instrument to correct economic imbalances. Such imbalances might arise because the process of adjustment and restructuring set in motion by the removal of physical, technological and regulatory barriers is unlikely to run smoothly or always produce satisfactory results within reasonable periods of time. Imbalances might also emanate from labour and other cost developments in one member country, external shocks with differing repercussions on individual economies, or divergent non-monetary policies pursued at national levels. As was pointed out in Part I, in a monetary union such imbalances would have to be detected and eliminated rather quickly, or their emergence be avoided altogether, in order to make it possible to reap the benefits of economic union without undue costs in the form of marked pressures on output and employment in certain regions of the Community.

12. It is primarily for these reasons that the creation of an economic and monetary union would need to complement the creation of a single market through action in three interrelated areas: competition policy and other measures aimed at strengthening market mechanisms; common policies to enhance the process of resource allocation in those economic sectors and geographical areas where the working of market forces needs to be reinforced or complemented; and binding rules in the budgetary field and other arrangements both to limit the scope for macro-economic divergences between member countries and to design an overall economic policy framework for the Community as a whole.

13. Competition policy - conducted at the Community level - would have to operate in such a way that access to markets were not impeded and market functioning not distorted by the behaviour of private or public economic agents. Such policies would have to address conventional forms of restrictive practices and the abuse of dominant market positions, but would also have to deal with new aspects of antitrust laws, especially in the

field of merger and takeover activities. In particular, attention would have to be paid to the problem of excessive government subsidies in favour of certain industries, since state aids do not merely distort competition but result in the longer run in an inefficient use and allocation of scarce economic resources.

In addition to clearly formulated policies for the dismantling of barriers and the prevention of restrictive practices, efforts might also 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.

14. Community policies in the regional and structural field would be of imperative importance in order to promote an optimal allocation of resources and a balanced distribution of wealth throughout the Community. In this context it should be recognised that almost all economic policies have regional implications and that in formulating such policies their regional dimensions would have to be taken into account. Without adequate consideration for regional imbalances, the economic union would be faced with grave economic and political risks. For this reason particular attention would have to be paid to an effective Community policy aimed at cushioning regional and structural disparities and promoting a balanced development throughout the Community.

The creation of a single market and the locking of exchange rates would take place in a situation in which owing to ill-adapted structures and differences in productivity, some major regional disparities would still exist. The impact of economic and monetary integration on these disparities could differ considerably and might therefore be difficult to assess: on the one hand, economic integration would provide less developed regions with lower wage levels, an opportunity to attract modern and rapidly growing service and manufacturing industries for which the choice of location would not necessarily be determined by transport costs and market proximity. On the other hand, however, transport costs and economies of scale would tend to favour a shift in economic activity away from less developed regions, especially at the periphery of the Community, to the highly developed areas in its centre. The economic and monetary union should avoid undue economic and political tensions arising from possible dislocations of industries and labour forces. Therefore, it would have to encourage and guide structural adjustment which would help the Community's poorer regions to catch up with the wealthier ones. To this end, the Community would have to develop further an effective policy and be endowed with adequate financial resources which would allow it to assist regional development efforts undertaken at national levels.

A step in this direction was taken in February 1988 when the European Council decided to strengthen and reorganise the Community's regional policies in two respects: the size of structural funds will be doubled over the period leading to 1992 and emphasis will be shifted from project to programme financing. However, the process of creating economic and monetary union would tend to exacerbate regional imbalances, such policies would have to be strengthened further after 1992.

The principal objective of regional policies should not be to subsidise incomes and simply temper inequalities in standards of living but to help to equalise the conditions for production through investment programmes in such areas as physical infrastructure, communication, transportation and education so that large-scale movements of labour would not become the major adjustment factor. The success of these policies would hinge not only on the size of the available financial resources, but to a decisive extent also on their efficient use and with due regard to the profitability of the investment programmes. Indeed, the more recent experience of countries inside and outside the Community has shown that structural and regional development programmes were particularly successful when improvements in the resource base of regions encouraged by investment in infrastructure and education were reinforced by decentralised initiatives for local entrepreneurship, modernisation of urban areas and local institutional arrangements favouring development. A long-term approach would offer countries with lower levels of productivity an appropriate period of transition and in this sense would constitute an essential element of the policy mix to ensure continuing economic integration.

As was mentioned above, a satisfactorily balanced regional development would also have to be supported by other economic policies. In certain areas such as transport, research and technological development, and environment, the EC Treaties as amended by the Single Act have laid the foundations of Community policies which would not only enhance efficiency but could also be employed with a view to regional development. Subject to the limits of the principle of subsidiarity, such policies would have to be expanded further in the process to economic and monetary union.

Sufficient wage flexibility and labour mobility could also help to ease regional problems and contribute to avoiding changes in competitiveness in different regions of the Community that could lead to relatively large declines in output and employment in areas with deteriorating competitiveness. In order to reduce adjustment burdens temporarily, it might be necessary in certain circumstances to organise financing flows through official channels. Such financial support would be additional to what may be provided by spontaneous capital flows or external borrowing and should be granted at conditions that would prompt the recipient to intensify its adjustment efforts.

15. Macro-economic developments are the third area in which action would be required. While policies to ensure a proper distributional and allocative functioning of the market without frontiers would have to be formulated and, in part, executed at the Community level, many of the 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 market-determined behaviour, but in particular also to budgetary policies. Aside from a system of binding rules governing the size and the financing of national budget deficits, decisions on the level and composition of government spending and many revenue measures would remain the preserve of member states even at the final stage of economic and monetary union. Only if the decision were taken that major public goods constituting the bulk of public sector activity (internal and external security, justice, social security, environment) should to a large extent be provided at 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 prudent 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. This is why all countries would have to accept that sharing a common market and a single currency area imposes narrow constraints on budgetary policies and requires strict fiscal discipline. Similarly, strong divergences in wage levels not justified by different trends in productivity would produce economic and monetary tensions.

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. In particular, in the financial field, 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.

For this reason an economic and monetary union would require binding arrangements which would enable the Community to monitor its overall economic situation, to assess the consistency of developments in individual countries and with regard to common objectives and to formulate guidelines for policy. This would be particularly important for budgetary policies, where binding arrangements were required. Such arrangements should, firstly, impose effective limits on budget deficits that could be incurred by individual member countries of the Community. However, in setting these limits the particular 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 monetary financing, as well as on borrowing in non-Community currencies. Finally, 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.

16. In <u>summary</u>, the establishment of an economic union would require:

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

These requirements would not only have to be met in order to derive the greatest possible benefit from an enlarged economic space, they would also be indispensable for the cohesion of the monetary union.

4. Institutional arrangements

17. Management of the economic and monetary union therefore would call for <u>an institutional framework</u> 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 constellation of Community institutions (European Council, Council of Ministers, European Parliament, Commission and Court of Justice). The establishment of economic union would not necessarily require the creation of a new institution, but the formulation and implementation of common policies in non-monetary fields and the co-ordination of policies under the competence of national authorities, could require a revision and, possibly, some restructuring of existing Community institutions.

18. The need for a new monetary institution would arise because a single monetary policy could not be decided and implemented independently by different central banks and because decisions concerning day-to-day monetary policy operations would have to be centralised if they were to respond quickly to changing market conditions. For these reasons the Community's domestic and international monetary policy would have to be organised in a <u>European System of Central Banks</u> (ESCB). The System could consist of a central institution, with its own balance sheet, and national central banks. At the final stage the ESCB - acting through its Council - would formulate and decide the targets of monetary policy and manage the Community's exchange rate vis-à-vis third currencies. The national central banks would be entrusted with the implementation of policies in conformity with guidelines established by the Council of the ESCB and in accordance with instructions from the central institution.

The European System of Central Banks, which would embody the Community's monetary order, should rest on the following basic principles:

<u>Status</u>

- independence of instructions from national governments and Community authorities;
- a proper democratic legitimisation through reporting and appointment procedures;
- appointment of the members of the Board by the European Council on proposal by the ESCB Council; the tenure of Board members would be for five to seven years and it would be irrevocable;

- transmission of an annual report by the ESCB to the Council of Ministers and the European Parliament; the Chairman of the Board could be invited to report to these institutions;
- supervision of the administration of the System independently of the Community bodies, for example by a supervisory council or a committee of independent auditors;

Structure and organisation

- a federative structure, since this would correspond best to the political structure of the Community;
- the establishment of a European Central Bank Council (composed of the governors of central banks and the members of the Board) which would be responsible for the formulation of and decision on the thrust of monetary policy;
- the establishment of the Board (with its supporting staff) which would monitor monetary developments and oversee the implementation of the monetary policy;
- national central banks which would execute the day-to-day operations in accordance with instructions given by the Board;

Mandate and functions

- the System would be responsible for the formulation of monetary policy at the Community level, for the co-ordination of policy implementation at the regional level and for the maintenance of a properly functioning payment system; the System would be committed to regulate the amount of money in circulation and of credit supplied by banks and other financial institutions on the basis of criteria designed to ensure price stability as well as economic growth;
- the System would be responsible for the formulation of banking supervisory policy at the Community level and co-ordination of banking supervision policies of the national supervisory authorities;

<u>Policy instruments</u>

- the instruments available to the System would be specified in its statute, together with a procedure for amending them; the instruments would comprise both regulatory powers and the authority to conduct central banking operations in money and foreign exchange markets;
- there would be strict limitations of lending to all public authorities;
- the monetary policy instruments would be oriented towards a free market economy;

19. The institutional requirements for effective conduct of <u>economic policies</u> should be assessed in the light of the functions which would be performed at the Community level. As noted in the previous section, there would be three broad areas in which the Community would have to be involved: firstly, the establishment and maintenance of a single market for persons, goods, services and capital; secondly, the formulation and implementation of common policies aimed at strengthening and balancing the process of market integration; and thirdly, co-ordination of macro-economic policies, in particular with a view to applying a framework of binding rules which would enable the Community to avoid major differences in public sector borrowing requirements between individual member countries, follow a common policy with regard to the financing of budget deficits and to formulate a macro-fiscal policy stance of the Community.

The necessary institutional framework for performing these three tasks is already in place with different, though partly overlapping, functions conferred on the Council, the European Parliament, the Commission and the Court of Justice. In order to ensure a flexible and effective conduct of policies in those economic areas in which the Community would be involved, two basic requirements would have to be fulfilled: firstly, to the extent that policies were decided and enacted at the Community level, there would have to be a clear distribution of responsibilities among the existing Community institutions, with due regard to whether decisions relate to the setting of broad policy directions or to day-to-day operations in the light of current developments. Secondly, in those areas in which the Community's role would be to co-ordinate policies, its task would have to involve the application of a system of binding rules to individual member states. By analogy with the structure of the European System of Central Banks, where the ESCB Council would determine the broad lines of monetary policy and the day-to-day execution of these policies would be in the hands of the Board, a similar allocation of responsibilities between the Council of Ministers and the Commission could be envisaged in the economic field.

In order to be able to carry out their functions within the existing institutional framework, the Community bodies would have to possess adequate instruments and means. As far as the implementation of the single market is concerned, the necessary procedures and arrangements have been laid down in the Treaty of Rome and the Single Act, conferring upon the Community the legislative, executive and judicial authority to put the internal market programme into effect.

With regard to common policies aimed at strengthening the functioning of the single market, the foundations for a more effective Community role in regional and structural policies had recently been put in place, involving both a doubling of the resources of structural funds and a reorganisation of policies. At a more advanced stage of the process these mechanisms might be further extended and made more effective.

In order to enable the Community to pursue an appropriate macro-economic policy, new procedures would have to be developed. These procedures would have to define and maintain a fair balance between co-ordination through binding rules fixing a set of objectives and constraints and discretionary co-ordination adapted to a particular economic situation. This would imply a need for both horizontal co-ordination - between member countries and the Commission and the Council - and vertical co-ordination between a member country and the Commission.

The objective of the co-ordination of macro-economic policies is to determine a strategy for growth and employment in an environment of price stability and economic cohesion. For this purpose co-ordination would have to aim at: defining medium and short-term policy approaches, bearing in mind all their economic and social implications; setting a multi-year framework for national and Community budgetary policies; managing common policies, particularly with a view to improving economic and social cohesion; and determining, in close consultation with the ESCB Council, the Community's exchange rate policy.

The most difficult and most important task in this context would be to develop an effective procedure for joint decision-making on the overall stance of fiscal policy, i.e. the size and the financing of the aggregate budgetary position in the Community. In this context the Community must be given the possibility of directly influencing the budgetary policies of individual member countries through a system of binding rules and by collective decisions.

While the involvement of the Community in non-monetary policies would be based on the existing institutional setting, it would be of paramount importance that the ensuing policy decisions resulted in a coherent and consistent set of measures which would clearly signal the Community's policy stance. Without an unequivocal formulation of economic policies, in particular in the fiscal field, the responsibility for macro-economic policy for the Community as a whole would fall virtually entirely to the European System of Central Banks. This would not only cede too great a responsibility to the monetary authorities, it would also leave the Community with only one macro-economic policy tool and therefore significantly impede an effective policy geared to stability and growth.

20. The new Treaty laying down the programme, procedures and organs of the economic and monetary union would create a situation in which the existing Community institutions (European Council, Council of Ministers, European Parliament, Commission, and Court of Justice) would be supplemented by a new institution of comparable status, the European System of Central Banks. Relationships and interactions between these bodies would have to be defined not only in order to construct a consistent institutional framework, but also to ensure an effective procedure of consultation and co-ordination between fiscal and monetary policies. To this end appropriate and regular relations between the existing institutions and the European System of Central Banks would have to be established which would provide for consistent consultation procedures without, however, impinging on the policy responsibilities entrusted to each institution in its own field of economic and monetary management. Such consultation procedures could include participation by the President of the Council and the President of the Commission in meetings of the ESCB Council, and participation by the Chairman of the ESCB Council in meetings of the Council of Ministers. Moreover, the involvement of the European

Parliament and national parliaments in the co-ordination process should be strengthened and the European Parliament should be consulted in advance on the stance of economic policy in the Community. The consultation process should include a yearly joint assessment of the overall economic and monetary situation and prospects, and the formulation of a general policy guideline for the year to come. Moreover, the Council of Ministers and the Commission should submit a report each year to the European Council and the European Parliament on the functioning and the status of the economic and monetary union.