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Introduction

Progress towards economic and monetary union has a double significance for the current development of the European construction.

On the one hand, it can be seen as the natural complement of the full realization of the Single European Act and of the realization of the 1992 objective: the internal market without frontiers. From an economic and social point of view, the Member States and the citizens of the European Community will only fully benefit from the positive effects of the creation of the large common market and cooperation if they can use a single currency — the ecu — and if they are capable of reinforcing their cooperation, and consequently the convergence of their macroeconomic policies.

On the other hand, to be fully effective, economic and monetary union requires a qualitative institutional jump which will bring the Community considerably nearer to a political union. How is it possible to envisage this union if the Member States are not in agreement either with its necessity or with the objectives of economic and social policy? This agreement, which is already often expressed within the present framework of the functions of the Community, is founded on the conviction that Member States have a common view of their essential interests and are convinced that, by acting in common, they expand their capabilities with regard to both their own internal development and the duties which fall on them in external affairs.

Thus, a new frontier is taking shape for the Community, which, in any case, needs to have the means for reinforcing its capacity for action and its efficiency in the areas of foreign policy and of security, which is the other essential element for building a European union, and which the Single European Act recalls, in its preamble, constitutes the political objective of the 12 Member States.

To advance harmoniously towards this European union, the Community will have to have an institutional schema which meets the two imperatives of efficiency of action and of democratization of the decision-making process. The preparation of the necessary amendments to the Treaty of Rome is the task of two intergovernmental conferences, one for economic and monetary union and the other for strengthening the political dimension of the Community, including the desired expansion of its powers.

These two courses of action are therefore interconnected and must lead to a common philosophy on the institutional framework. A constant link must therefore be maintained between the two series of negotiations in order to ensure a consensus on the objectives and coherent approaches to debate, democratization, decision-making and the implementation of decisions.

Without doubt, this will be the occasion for a wide-ranging debate, enriched — at least as far as the six founder countries are concerned — by the experience of nearly 40 years of living together. What can we learn from this short history? That the founding fathers of the Community, with imagination and realism, devised a system which would make possible the gradual integration of our countries in a setting where the workings of the institutions are open, dynamic and, moreover, realistic, since every step forwad must be ratified by the sovereign bodies of each country. Given the success already achieved, thanks in particular to the balanced working of the existing institutions, we must take care that, even with the best of intentions, we do not arrive at a system which is bogged down in sterile tensions between Community institutions or in irresolvable conflicts between Community decisions and national wishes, between the European Parliament and national parliaments.

This consideration, which is of prime importance in the eyes of the Commission, has led it to suggest a plan for economic and monetary union which incorporates the basic principles of the Treaty of Rome so that the interest of the Community is constantly promoted by the European Commission, this being one of the roles assigned to that institution, though not its exclusive privilege. Having noted this, the decision-making mechanism is still based on the Council of Ministers, while the desire for democratization leads us to recommend more active participation by the European Parliament. Alongside this institutional triangle the European Council is confirmed in its role as a driving force in the construction of Europe. The Court of Justice is destined to become more and more the court of appeal in disputes over the application of the rules of the Treaty, a sort of embryonic constitutional court.

This is the spirit which has inspired the Commission in outlining the institutional aspects of economic and monetary union, on the understanding that a single monetary policy and a single currency can only be managed by a single body yet to be created. This is the only new institution required by this plan. It has been conceived with two considerations in mind: efficiency and the principle of subsidiarity. It will have the independence necessary to carry out its mandate, the unremitting pursuit of price stability, which is required not only to have a strong currency but also to permit continuous, durable growth creating jobs and prosperity.

The same principles will guide the European Commission when, as for economic and monetary union in the present document, it comes to make its proposals for the second intergovernmental conference, to be devoted in the European Council's own words to 'political union'.

Of course, nothing would have been done, nothing can be done, without a strong political will expressed clearly by the Member States. But it is worth repeating that nothing would have been done or can be done without an institutional system which, while taking account of the legitimate interests arising from the situation of each country, is also able to identify the general European interest and then to firmly promote it.

The new impetus for economic and monetary union started with the Hanover European Council of 1988 deciding to entrust a committee with 'the task of studying and proposing concrete stages leading towards this union'. On the basis of the Delors Committee Report, the Madrid European Council decided one year later that Stage I of economic and monetary union would start on 1 July 1990 and asked for the preparation of the Treaty changes necessary for Stages II and III. Now, the first stage of economic and monetary union has come into effect as foreseen and the June European Council in Dublin has consolidated the drive in favour of economic and monetary union by noting 'that all the relevant issues are being fully and thoroughly clarified', by deciding that the intergovernmental conference for agreeing on the necessary Treaty changes will open on 13 December 1990, and by stating that further work should be carried out 'in such a way that negotiations on a concrete base can be entered into as soon as the conference opens'.

In recent months the Commission has made contributions to the clarification of the major issues in all bodies concerned with the preparation of the intergovernmental conference. The present communication not only presents a synthesis of the Commission's view but also attempts to build a consensus in bridging, as far as possible, the opinions expressed in these bodies. The UK Government's position has also recently evolved positively by accepting, in its 'hard ecu' proposal, the necessity of a Treaty revision, the creation of a common monetary institution and that the ecu could eventually become the single currency in Europe. In this communication reference is made to the proposal, but it is not seen as fitting easiliy into the general conception, based on the Delors Committee recommendations, on which widespread agreement has emerged not only between the other Member States, in the Council as well as in the Committee of Central Bank Governors, but also in the European Parliament.

This communication is the contribution of the Commission for a full and adequate preparation of the intergovernmental conference. The Commission is confident that the timetable envisaged by the Dublin European Council of ratification before the end of 1992 can be kept. It is therefore proposed to start Stage II on 1 January 1993. It is essential to make good use of the time until then; indeed, the first stage should make it possible to achieve a high degree of convergence, to reinforce monetary policy coordination and to promote the role of the ecu. The second stage would then become a phase of intensive preparation during which the European System of Central Banks would be set up. While there is already now a clear economic case for a short duration for the transition, the beginning of Stage III and the introduction of the ecu as the single currency would be the subject of political agreement by the European Council.

For the definitive economic and monetary union, the communication advocates a design similar to that of the Delors Committee Report. Economic and monetary union is a whole; the European Council would be concerned with the overall coherence of the Community's economic and monetary policy. The Commission proposes that the Treaty should designate the ecu explicitly as the future single currency of the union. Moreover, a single monetary policy is required which will have to be determined in a centralized way by a new Community institution. The new institution would be independent and democratically accountable; the institution would be committed to the objective of price stability and, subject to the foregoing, should support the general economic policy set at the Community level by the competent bodies.

Economic union would be founded on the internal market, on closer coordination of economic policies and on the development of common policies. This requires a reinforcement of multilateral surveillance. Two rules concerning budget deficits (no monetary financing and no bailing-out) should be introduced into the Treaty. The Treaty should also state the principle that excessive budget deficits must be avoided. Furthermore, two new economic policy instruments would be created: multiannual guidelines for economic policy to be formally endorsed by the European Council and a specific financial support scheme which would be activated when major economic problems arise or when economic convergence calls for a particular Community effort alongside national adjustment strategies in the sense of positive conditionality.

Common policies would be further developed in the economic union with the aim of improving economic efficiency and fostering economic and social cohesion. For improving economic efficiency a growing Community involvement in policy areas with important European-wide effects should be foreseen and, when necessary, present Treaty provisions be extended or modified. In the final stage of economic and monetary union there might also be the need to further strengthen Community structural policies; their instruments and resources would have to be adapted to the needs of the union. For the structural Funds, consideration should be given to widening the eligibility criteria and to endowing them with a greater capacity to respond more quickly and more flexibly. Furthermore, the new special financial support scheme might be used in favour of the cohesion objective on condition that this fosters economic convergence more generally.

* * *

To put the role of the intergovernmental conference in its proper context, it should be recalled that at the same time the construction of Europe is continuing at a rapid pace, stimulated as it is by the results already achieved in the economic and social spheres, by the implementation of the Single Act and the prospects which it offers, and pushed forward as it is by the demands from the outside world, especially the larger Europe in the process of rapid change.

More than ever since its history began, the Community is under pressure to define the level of its ambitions and to take up the responsibilities which are incumbent on a group of rich countries with their history, culture and material potential.

Without awaiting the outcome of these conferences, the Community must therefore demonstrate its ability to take up these two challenges, internal and external. It must not let itself be diverted by its discussions on the two plans for the future constituted by economic and monetary union and political union. Indeed, it will not be able to put these plans into effect unless at the same time it reinforces the credibility of the objectives of the Single Act and lays the foundations for the new system of international relations in which history has reserved for it, if it has the will and the means, an important role alongside the other great world powers.

Among the objectives which the Community has to achieve, only those which are fully associated with the success of economic and monetary union are mentioned here: the single market by the end of 1992, reinforced cooperation in the fields of research and technology, the environment, infrastructure networks, the social dimension and, even more directly, economic and social cohesion. This last objective, which is written into the Single Act, is at present being pursued by means of structural policies aimed at giving each region a chance with the corresponding responsibility for planning and implementing its own development. A first balance-sheet of these new policies, decided by the European Council in February 1988, will be drawn up by the Commission at the end of next year. Thus, the European Council will be in a position to assess the appropriateness of the approach, the need for adjustments or additional measures and the means to be allocated to the policies, in terms of both financial and human resources.

During the same period, the European Monetary System will further demonstrate its essential contribution to economic convergence and the pursuit of European monetary stability in a world characterized by unstable foreign exchange markets and sharp fluctuations in the financial sector. Together with the multilateral economic surveillance exercises conducted by the Economic and Finance Ministers and the strengthened role of the Committee of Governors, the EMS will be one of the three pillars of Stage I of economic and monetary union. Once again, therefore, we are reminded of the importance of the Community's day-to-day activities for the achievement of its long-term objectives.

1. Benefits and costs of economic and monetary union

The economic impact of economic and monetary union will deeply affect the workings of the Community economy, and will go to the heart of the determinants of both inflation and growth. Moreover, its repercussions will extend as far as influencing the management of the world economy.

The benefits and costs of economic and monetary union are the subject of an extensive analysis currently being completed by the services of the Commission, with contributions from independent experts. This study will be published by the Commission in the near future, thus underpinning the summary presented in the following paragraphs.

While quantification of many partial features of the overall economic impact will be possible, there are fundamental reasons why an aggregate estimate of the impact of economic and monetary union is not feasible (unlike the Cecchini Report on 1992). This is because economic and monetary union will cause a very complex chain of reactions: the systemic changes will lead to policy changes, and both will condition behavioural changes in the economy, before arriving at the final impacts in terms of economic well-being. Much of the impact will therefore be indirect, and conditional on the responses of governments as well as private economic agents.

There will, none the less, be important linkages between the real economic impacts of the completion of the internal market by the end of 1992 and economic and monetary union. A single currency is the natural complement of a single markt. The full potential of the latter will not be achieved without the former. Going further, there is a need for economic and monetary union in part to consolidate the potential gains from completing the internal market, without which there could be risks of weakening the present momentum of the 1992 process. Economic and monetary union therefore offers the prospect of consolidating the single market as well as bringing its own value-added to the performance of the Community economy.

1.1. Definition

Economic and monetary union is a whole. The definition given here follows the Delors Committee Report on both the monetary and economic sides.

Monetary union is recognized as either irrevocably fixed exchange rates or a single currency; a single monetary policy is the central characteristic of both these regimes. The single currency is clearly the first-best in terms of the economic benefit / cost ratio.

Economic union would see a much lesser centralization of policy competences than monetary union, following the principle of subsidiarity. It would be founded on the internal market and would require the Community to have common economic objectives and a close coordination of economic policies as well as the development of the common policies. Budgetary policies, at national and EC levels, would be affected in important ways as proposed below.

For the purpose of analysing the benefits and costs of the definitive economic and monetary union, as just defined, the point of comparison must be identified. For this purpose, the comparison may be made with a Community that would have completed its 1992 programme for the internal market and retained the European Monetary System (1992 plus EMS). However, this is an abstract point corresponding to stated ambitions. In reality such a point may not exist since, in the absence of expectations of progress to economic and monetary union, 1992 plus EMS might well prove not to be stable. This is because complete capital liberalization and exchange rate stability impose virtual unity of monetary policy. In other words, if the dynamics of economic and monetary integration progress are not recognized, extra costs might have to be borne because of difficulties in sustaining the present system. This means that the benefits of moving to economic and monetary union would effectively be greater.

1.2. Major benefits and costs

These may be grouped under the following headings:

(i) *Efficiency and growth.* Elimination of exchange rate variability, uncertainty and transaction costs, and further refinements to the single market are sure to yield gains in efficiency. Through improving the risk-adjusted rate of return on capital (adjusted for exchange rate related risk and uncertainty factors), and the business climate more generally, there are good chances that a credible commitment to achieving economic and monetary union in the not-too-distant future will help further strengthen the trend of investment, growth, and employment.

(ii) *Price stability.* This is an objective *sine qua non* for economic and monetary union. It is also beneficial economically in its own right, for example through allowing the price mechanism to work efficiently for resource allocation purposes. The main problem for policy-makers is that of attaining price stability at the least cost, and then maintaining it. The Community has the opportunity of being able to build its monetary union on the basis of the reputation for monetary stability of its largest national economy, and more recently, increasingly also of other narrow-band participants in the EMS. Given the paramount importance of credibility and expectations in winning the continuous fight against inflation at the least cost, this is a great advantage.

(iii) *Public finance.* A new framework of incentives and constraints will condition national budgetary policies, which will be generally conductive to macroeconomic discipline and stability. Economic and monetary union will bring valuable gains for many countries' national budgets through reductions in interest rates, as inflation and exchange risk premiums are eliminated. These benefits will outweigh the loss of seigniorage revenue to be experienced by some countries.

(iv) *Employment and regional balance.* The improved prospects for growth outlined above will contribute to increased employment. The main potential cost of economic and monetary union is that represented by the loss of the nominal exchange rate as an instrument of economic adjustment. This loss should not be exaggerated for several reasons: exchange rate changes by the Community in relation to the rest of the world will remain possible, whereas within the Community the nominal exchange rate instrument is already largely abandoned; far from freezing relative labour costs and competitiveness, economic and monetary union, in the right policy context, will encourage necessary changes, and policies at national and Community levels will also absorb shocks and aid adjustment. In its present form, the external current account constraint will disappear for individual Member States which will be a great advantage, even if the national performance in trade of goods and services will continue to have some influence. For the EC as a whole the constraint will of course remain.

(v) *The international system.* With the ecu becoming a major international currency, there will be advantages for the Community as banks and enterprises conduct more of their international business in their own currency. Moreover the monetary authorities will be able to economize in external reserves and achieve some international seigniorage gains. Economic and monetary union will also mean that the Community will be better placed, through its unity, to secure its interests in international coordination processes and negotiate for a balanced multipolar system.

1.3. Benefits and costs in the processes of convergence and the transition

Much progress has been made in the Community recently in convergence in terms of inflation, cost trends and sound public finance. Even the presently more divergent economies could plausibly now adapt their medium-term economic strategies to the prospects of full participation in economic and monetary union.

The costs of the transition to economic and monetary union (for example disinflation, and the reduction of budget deficits) for those countries would be greatly reduced by the setting of clear political commitments with fixed dates. If economic agents (public authorities, companies, trade unions, individuals) perceive these commitments to be credible, they will anticipate the effects of economic and monetary union in their economic strategies and behaviour. Such a process has already been at work to advantage with the 1992 programme, and a similar strategy could be equally beneficial for economic and monetary union, if not more so.

Since most of the costs of moving to economic and monetary union arise in the preparatory stages of the economic and monetary union process, whereas some of the important benefits (elimination of exchange rate uncertainty and transaction costs, a better international system) arise only in the definitive regime with a single currency, there is a clear economic case for a short duration for the transitional period.

As regards the regional distribution of the impact, which is relevant to the objective of longer-term convergence of economic performance, there are no a priori grounds for predicting the overall pattern of relative gains and losses. There are risks and opportunities of different types affecting all categories of regions. However, social and economic cohesion involves the reduction of existing regional disparities as well as ensuring that economic and monetary union does not lead to any increase in disparities. Policy actions already seek to achieve these aims and to reduce locational disadvantages. The performance of structural and regional policies will have to be evaluated and if necessary be adapted and strengthened in the light of experience. However, the key to the catching-up process lies in obtaining synergies between Community policies (for 1992, the structural policies and the move to economic and monetary union) and national efforts to upgrade the least favoured regional economies and to prepare for 1992 by supply-side measures. The fixing of clear policy objectives, such as for the internal market and economic and monetary union, are also highly relevant here for mobilizing such efforts.

1.4. Overall evaluation

Summarized in terms of the conventional distinction between the three major objectives of economic policy, the likely impact of economic and monetary union is:

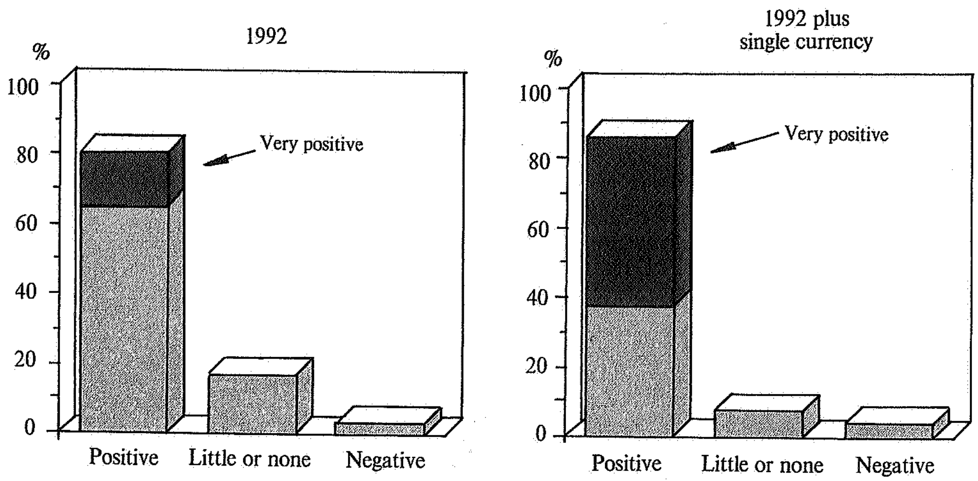
(i) efficiency and growth: sure advantages, as a single currency and economic union complements the single market and adds to its impact. Economic analysis supports the perceptions of industrialists. One market needs one money (see Graph);

(ii) stability: sure advantages as regards better overall price stability (i.e. both very low inflation on average, and low variability) assuming that the design of the system is handled well, and likely gains also in terms of the stability of the real economy (lesser fluctuations in output and employment);

(iii) equity: no a priori balance of relative advantage for any particular type of region. Nevertheless, in the light of experience, structural and regional policies will have to be evaluated and if necessary be adapted and strengthened. However, the currently less well-off regions have a real opportunity for rapid catch-up, if they maximize potential synergies between EC policies (in particular the structural ones) with national development efforts. Economic and monetary union, like 1992, is a positive-sum game.

GRAPH: A business perception of the microeconomic impact of EMU

Opinions on the prospects for the business climate become very much more positive when a single currency complements the single market.



Source: Business survey undertaken for the Commission of the European Communities by Ernst & Young.