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Mr Ryelandt
Commission of the European
Communities
200 Rue de la Loi
1040 Brussels

Your reference

Our reference

Date 27 August 1973

Dear Mr Ryelandt,

It occurs to me that you might like to see the paper our representative is putting into the Council Group on Economic and Monetary Union. I am therefore enclosing a copy on a personal basis. I have given another to Morel.

Yours sincerely,
R P Culpin

R P Culpin

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GROUP ON ECONOMIC AND MONETARY UNION

CONCRETE SUGGESTIONS FOR THE SECOND STAGE OF ECONOMIC AND MONETARY UNION

Note by Mr L Airey

At the first meeting of the Group, the Chairman invited members, if they wished, to submit papers setting out their views about the second stage of economic and monetary union (EMU). This note responds to that request by putting forward certain suggestions on a tentative and personal basis. It is not, therefore, intended to represent the definitive position of the UK Government.

2. The suggestions draw heavily on the two relevant and extremely useful communications from the Commission to the Council (documents COM(73) 570 Final and COM(73) 1099) and are based on the Commission's assumption that the second stage should last from 1 January 1974 to 31 December 1976. In broad accordance with the classification adopted by the Commission, they are grouped under seven main headings: improved co-ordination procedures; external monetary matters; structural policies; tax harmonisation; capital market; the Community budget; and Community institutions. In those areas in which the Group's terms of reference require it to produce detailed proposals (eg improved co-ordination procedures), the suggestions are put forward as possible concrete measures for the second stage; but in those areas where the Group is asked not to duplicate detailed work being undertaken elsewhere (eg structural policies), the suggestions are more in the nature of general statements which might appropriately figure in the Group's report; and in the area of external monetary matters, the suggestions are subject to detailed technical elaboration by the competent bodies. Almost all of them have as their justification one or more of the following five objectives:

- i. the need to build on and formalise the progress achieved in the first stage;
- ii. the need to reinforce the measures adopted in the first stage by a comprehensive package of further measures which pays full regard to the agreed principle of parallelism;

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iii. the need to increase involvement by the Community as a whole in the processes of policy formulation in member states and to prepare the ground for transfers of responsibility to Community institutions;

iv. to that end, the need to adopt consistent definitions and methodologies for the formulation of economic and monetary policies in member states; and

v. the need in certain important areas to make studies and draw up blueprints on the basis of which to plan for the full achievement of EMU.

I Improved Co-ordination Procedures

3. In the course of the first stage, mainly as a result of the Council Resolution of 22 March 1971, the Community has created an elaborate system of Ministerial and official procedures for co-ordinating economic and monetary policies in member states in accordance with Community objectives. What is needed most in the second stage is to make these procedures work more effectively. There are two requirements for this. First, the forecasting and analytical basis on which Community discussion of economic and monetary policies take place must be improved. This is an essential precondition for making the economic and monetary policy guidelines sufficiently specific, comprehensive and soundly-based. Secondly, ways must be devised of ensuring that the implementation of the guidelines in each member state is properly monitored; that member states whose policies depart significantly from the guidelines are obliged to justify their actions to their partners; and that the Community is in a position to bring some form of sanction to bear on member states who do not so justify themselves. In addition, the second stage should be the time in which the Community prepares for the degree of harmonisation of planning methods and policy instruments which will be necessary for the full achievement of EMU.

4. The following suggestions are put forward with these considerations in mind.

a. General Co-ordination Procedures

(1) Rolling three year programmes should be drawn up each year for

co-ordinating relations between national statistical institutes, the Statistical Office of the European Communities and other interested departments of the Commission, on the lines of the proposals discussed at the Conference of Directors-General of national statistical institutes.

(2) Rolling five year quantitative projections should be drawn up each year. On the basis of these, and recommendations by the Commission, the Council should adopt annually medium-term economic policy guidelines for the Community.

(3) The responsibilities of the proposed European Institute for Economic Analysis and Research should include the preparation at least once a year of independent short-term forecasts for the Community as a whole and the separate member states. These forecasts should be submitted to the Council and the Commission, which should take them into account in submitting its policy recommendations to the Council as a basis for the determination of short-term economic policy guidelines for the Community and the separate member states.

(4) The existing system of key indicators ("clignotants") should be developed and integrated within the co-ordination procedures. The Commission should monitor both the key indicators and the implementation of the short-term economic policy guidelines in the member states. Serious departures from the guidelines, or specified movement of the indicators, in one or more member states should trigger consultations in the appropriate committees, under the auspices of the Steering Group for the Co-ordination of Short-Term Economic and Financial Policies.

(5) In the course of these consultations, once triggered, the member state or states concerned should justify their policies to their partners. A report should then be made to the Council who should if necessary make specific policy recommendations to the member state or states concerned. In certain circumstances thereafter, the Council should be able to impose sanctions perhaps relating to access to credit and to interest rates on balances held with the European Monetary Co-operation Fund.

(6) The Council should adopt the proposed directive on stability, growth and full employment by 30 June 1974. This should require all member governments to make arrangements to ensure that they have at their disposal a sufficient range of economic instruments and regulators to be able to implement as quickly as possible those economic policy guidelines that the Council may decide to adopt.

b. Budgetary Policy Co-ordination

(7) The technical work that the Budgetary Policy Committee already has in hand should be intensified so that in the course of the second stage substantial progress is made towards the harmonisation of public expenditure planning procedures (definitions, methodology and time horizons) in member states.

(8) The^o determination of budgetary guidelines for member states, and the monitoring of budgetary performance throughout the year, should be continued and improved.

(9) There should be regular consultation about the implications of short-term budgetary financing in member states.

(10) A study should be undertaken by the Budgetary Policy Committee to devise means of improving the way in which the impact of budgetary policies on the real economy in member states is measured.

c. Domestic Monetary Policy Co-ordination

(11) Monetary guidelines for each member state should be determined and monitored annually.

(12) To this end, the Monetary Committee and the Board of Governors of the European Monetary Co-operation Fund (EMCF) should agree the adoption of a consistent definition of the main monetary aggregates in member states.

(13) A study should be undertaken, under the auspices of the Monetary Committee and the Board of Governors of the EMCF, of the link between the monetary aggregates and the real economy in member states and of the way in which the monetary instruments in the member states affect the monetary aggregates; such a study should aim to improve the basis on which monetary guidelines are drawn up and to help in assessing the extent to which monetary instruments may need to be harmonised in full EMU.

II External Monetary Matters

5. The Council has requested the Monetary Committee and the Board of Governors of the European Monetary Co-operation Fund (EMCF) for detailed technical comment and advice on the Commission's suggestions on the adjustment of short-term monetary support arrangements and the conditions for the progressive pooling of reserves contained in document COM(73)1099. It would be inappropriate for the Group to seek to pre-empt such advice. On the other hand, in its report to the Committee of Permanent Representatives, the Group will doubtless wish to recommend the broad lines of a suggested approach to these matters in the course of the second stage. The suggestions which follow attempt to set forth such an approach. They are all, of course subject to detailed technical advice and elaboration from the Monetary Committee and the Board of Governors of the EMCF.

(14) The EMCF should be endowed with:

- a. an equity capital in Community currencies;
- b. a proportion of the reserve assets of member states;

of amounts to be determined. Further endowments of reserve assets should be made at later stages.

(15) The definition of the unit of account of the EMCF and the rate of interest payable should be such as to ensure that a claim on the EMCF denominated in units of account should be acceptable as a reserve asset.

(16) A short-term credit facility, on the lines proposed by the Commission, should be introduced. There should also be a further facility, as referred to in the Commission's paper.

(17) The EMCF should monitor the operation of the narrower margins scheme ("the snake") and the pattern of exchange rates between member states' currencies, and make recommendations to the Council as necessary.

(18) The Monetary Committee in association with the Commission should report by 30 June 1974 on the prospects for achieving a greater degree of equal exchange control protection in all member states in regard to capital movements to and from third countries, as a first step towards greater liberalisation of capital movements within the Community.

(19) The Monetary Committee in association with the Commission should report by 30 June 1974 on possible ways of improving control over short-term capital movements both within the Community and in relation to third countries.

III Structural Policies

6. The details of the structural and regional policies which will form part of the second stage will not be for the Group to pursue. However, the Group's terms of reference require it to take broad account of the relevance to its work of policies in this field. With this in mind, the following suggestions are put forward for possible inclusion in the Group's report.

(20) The importance of structural and regional policies for the achievement of EMU should be reaffirmed. The Medium Term Economic Policy Committee should draw up a list of indicators of structural convergence between member states' economies. Movements in these indicators should be monitored by the Commission and attention paid to them in considering further progress towards EMU.

(21) Decisions on regional and social policy should be adopted by 31 December 1973.

(22) The Commission should report by 30 June 1974 on the details of its proposed scheme for Community support for unemployment allowances, designed to promote equilibrating transfers of resources between member states.

IV Tax Harmonisation

7. Tax harmonisation is an area, like that of structural policies, where the Group must be careful not to duplicate work already being undertaken elsewhere. However, in its report, the Group will probably wish to stress the continued importance of pressing on with the Council's programme for harmonising the structure of certain indirect taxes and of corporation tax. Moreover, the Group might also like to propose that in the course of the second stage a detailed study should be undertaken of the extent to which that programme of tax harmonisation might need to be further developed for the full achievement of EMU. Such a study would need, among other things, to take into account the importance of taxes as instruments of economic management in the member states and to bear in mind that attempts to harmonise tax rates would neutralize the effectiveness of taxes in this respect and would, therefore, need to be preceded by the establishment of alternative instruments of economic management at Community level.

8. The suggestions in the area of tax harmonisation for inclusion in the Group's report are therefore as follows:

(23) A study should be undertaken to see if further tax harmonisation is desirable for the full achievement of EMU, bearing in mind the importance of taxes as instruments of economic management and the consequent need to develop alternative Community instruments before harmonising national tax rates.

(24) The harmonisation of the structure of corporation tax should be vigorously pursued along the lines already agreed and under discussion elsewhere.

(25) The Council's programme for harmonising the structure of those indirect taxes which are to be retained on a Community basis - those on mineral oils, manufactured tobacco, alcohol, beer, wine and value added - should be vigorously pursued.

(26) The Commission should continue to pursue the work that it has already put in hand on the control of tax avoidance and evasion.

V The Capital Market

9. There have already been important reports on the question of harmonising capital markets and much detailed work is in hand on harmonising the practices of companies, financial institutions etc.

However, the Group may feel that it would be desirable to stimulate work in the areas covered by the following two suggestions.

(27) In the course of the second stage, the Council should adopt rules to improve disclosure of information by companies and unit and investment trusts in member states.

(28) The Commission should submit proposals by 31 December 1974 on ways in which the national rules governing the permitted investments of banks and other financial institutions should be made "transparent".

VI The Community Budget

10. The Commission's communication to the Council, document COM(73)570 Final, rightly recognised the important role which the Community budget will need to play in the full achievement of EMU. The Commission stressed that, in the course of the second stage, the budget should be made more flexible and that new functions assigned to it should be directed first and foremost at social transfers and transfers to establish equilibrium. This raises fundamental questions about the place of the Community budget in full EMU, bearing particularly in mind its relative insignificance compared with national budgets at present. It would seem desirable for the Community to undertake a study in depth of these crucial issues in the course of the second stage and the following proposal is framed with this in mind.

(29) In the course of the second stage, the competent bodies of the Community should prepare a report on the way in which the Community budget could be developed into a flexible instrument of economic management, appropriate to the full achievement of EMU.

VII Community Institutions

11. Several of the suggestions made above would, if accepted, lead to an important strengthening of Community institutions. In particular a good start would be made in developing the role of the EMCF into that of a major Community institution; and, in being given an independent responsibility for forecasting, the European Institute for Economic Analysis and Research would be in a position to play a part in the gradual process of increasing the extent to which responsibility for the management of national economies is assumed by the Community as a whole.

12. Other important questions about the development of Community institutions are under separate consideration at the moment. This is certainly the case in regard to the Commission's detailed proposals for strengthening the budgetary powers of the European Parliament and the views on this matter which the Parliament has itself expressed. It may, therefore, be felt inappropriate for the Group to make suggestions in this area except in the most general terms; and the first suggestion below is therefore formulated in such terms. The second suggestion is aimed at the possibility of securing some rationalisation of the existing economic and financial committee structure, which is of course of vital importance to the effective co-ordination of economic policies. And the third suggestion raises the possibility of setting up new Community institutions for export credit insurance and the financing of export credits, bearing in mind that, by the time of the full achievement of EMU, these matters will need to have become Community responsibilities.

(30) The powers of the European Parliament in relation to the Community budget should, where possible, be strengthened, in particular through the establishment of a Public Accounts Committee (as envisaged by the Parliament) in association with improvements in the arrangements for audit of Community expenditure.

(31) The role of the Steering Group for the Co-ordination of Short-Term Economic and Financial Policies in regard to the work of the other economic and financial committees in co-ordinating member states' economic and financial policies should be strengthened, as should its role in regard to the preparation of meetings of the Council (Finance Ministers). The Steering Group should report to the Council by 30 June 1974 on the present structure of official economic and financial committees, with recommendations, if necessary, for its improvement.

(32) The competent Community bodies should report before the end of the second stage on the possibility of setting up Community institutions for export credit insurance and Community financing of export credits.

Conclusion

13. I should welcome my colleagues' comments on the suggestions above, which I will of course be happy to amplify and clarify in discussion.