

COMMISSION OF THE EUROPEAN COMMUNITIES

SECRETARIAT-GENERAL

**Commission memorandum to the Council
on the preparation of a plan
for the phased establishment
of an economic and monetary union**

Brussels

4 March 1970

1. According to point 8 of the Hague communiqué, "within the Council, on the basis of the memorandum presented by the Commission on 12 February 1969 and in close collaboration with the latter, a plan in stages (is to) be worked out during 1970 with a view to the creation of an economic and monetary union".

As a contribution to the preparation of this plan, the Commission in the present paper sets forth its views as to the principles it feels should be borne in mind in the forthcoming discussions and the main aspects of the stages it considers could usefully be planned for the establishment of an economic and monetary union. It reserves the right to put any further proposals to the Council on the matter at a later date.

PRINCIPLES

A. Objective

2. As the Commission sees it, the objective, to be attained by stages, is twofold:

- (a) Internally, the Community must be turned, by an irreversible process, into a frontier-free economic area within which:
 - goods are traded freely;
 - services are not subject to arbitrary restrictions (freedom of establishment is an important factor here);
 - factors of production — manpower, management and capital — have genuine mobility, encouraged both by ample freedom of movement and possibly by certain incentives.
- (b) In respect of its relations with outside, it must be gradually transformed into an organic economic and monetary association having an individuality of its own, at a pace commensurate with the speed at which international economic relations are changing and chosen so as to enable Europe to contribute usefully to international economic co-operation.

This twofold aim must be achieved through the combined effect of market forces and of deliberate policy implemented by the national and Community authorities responsible. In this way there can come into being the "Stability and growth Community" a policy-goal approved by the Heads of State and Government.

B. Method

3. Any plan for the establishment of economic and monetary union must provide for joint framing of the policies necessary to the proper functioning of the Community, and hence must postulate joint risks and joint solidarity. The risks will be the better borne and the solidarity the more effective if those concerned are careful to abide by the rules and practices worked out by the Community institutions in putting these policies into operation. The factors must be in balance throughout and progress in parallel. Accordingly, the measures to be adopted will need to be decided in the light of a concept of "common interest" combining and going further than the mere addition of national interests.

A process whereby the obstacles to the interpenetration of the economies were simply abolished by legal enactment and it was left mainly to the Member States to ensure the cohesion of the Community and compatibility of the different economic trends would definitely not lead satisfactorily to economic and monetary union. In fact, such a method must be regarded as actually dangerous, since it would sooner or later produce situations of crisis.

It is a fact that the interpenetration of the economies is inevitably weakening the various instruments of control available to the national authorities, where it is not actually eliminating them altogether, so that random forces, or forces to some extent uncontrollable, in some cases gain the upper hand. It would make little sense, at the very time when the problem of steering the national economies is getting more and more complex in consequence of integration, to allow the steering gear to become unserviceable and put nothing in its place. Provision should therefore be made to ensure that wherever progress is deemed essential to unification Community instruments are introduced to replace or supplement the national instruments.

4. To secure the support of trade unions, business federations and other groupings in the member countries for the measures to institute economic and monetary union, arrangements would have to be made for regular concertation between the Community institutions on the one hand and the unions, employers' federations and other representative bodies in particular economic and social sectors on the other, the latter to be asked to state their views (the procedural details to be settled later) on the main lines to be followed in economic, fiscal and monetary matters, and on decisions of more direct interest to them.

C. Consistency

5. Care must be taken throughout, in working towards economic union, to see that the measures planned are mutually consistent.

(a) While it is true that monetary union, if it is to last, needs to be soundly based on economies evolving on compatible lines, with convergent economic policies, it is equally true that closer monetary solidarity enhances the prospects for both such compatibility and such convergence. The interaction of the economic and monetary sides is a powerful factor for greater Community cohesion.

Moreover, current international developments suggest that to delay overlong in giving the Community this greater monetary cohesion might eventually mean that the whole idea of monetary unification lost its point, economic unification was rendered largely irrelevant, and even the Community work already completed might be seriously undermined.

6. (b) A vigorous drive will need to be undertaken for the comprehensive ordering of the economy, by appropriate action with respect to monetary and financial policy, budget and tax policy, and incomes policy.

The process is more likely to develop smoothly if the co-ordination of the overall economic policies is accompanied by structural measures: for resources to be so allocated as to yield the optimum result for the Community as a whole, it will first be necessary to take steps to reduce those disparities in structures among the member countries which tend to hamper the formulation and implementation of joint policies.

The aim in so doing must not be to make the structures in the member countries all exactly alike, for this would spoil the effect of the intra-Community specialization that it is desired to bring about.

The object should rather be twofold, firstly to even out the existing disparities, by measures relating primarily to employment and regional equilibrium, and secondly to prepare the way more effectively for future growth, more particularly by action in the fields of industry and technology.

To produce the required impact the weapons employed should be few; greater use should be made, in any event, of those already to hand in the Community.

The success of the structural measures will depend as much on the way the funds are administered and deployed as on the actual amount provided. The emphasis should be on offering incentives and guidance, and even practical demonstration (assistance funds), rather than on simply providing unlimited and unconditional cover for needs arising. This means that there must be a close link between the terms on which finance is accorded and compliance with policy guidelines jointly agreed.

7. (c) Lastly, in view of the effects on economic equilibrium of disparities in tax arrangements, fiscal harmonization should be conducted *pari passu* with the other measures for introducing economic and monetary union.

Approximation of indirect taxes is essential inasmuch as unduly marked differences necessitate controls and countervailing dues at internal frontiers, favour the maintenance of market compartmentation, and enable markets to be sealed off in the event of economic difficulties.

Approximation of direct taxes is also necessary inasmuch as the creation of a European financial market would be hindered by different fiscal conditions, and these disparities would entail distortions in the competitive situations of firms and in investment plans.

D. Stability of exchange rates

8. This is one of the most important aspects of any plan for the establishment of economic and monetary union.

One prerequisite for economic and monetary integration is that the process of adjustment among the member countries should take place against a satisfactory background of stability and growth. To cope with the balance of payments difficulties that will still be liable to develop on occasion in the Community for some time to come, it has been suggested that, during a transition period, greater flexibility should be introduced into the exchange system within the Community, perhaps by use of the device known as the "crawling peg".

However, such an arrangement would have serious disadvantages. It would of its nature tend to make for divergence, rather than the desired convergence, in the development of the economies. It would prevent the adjustments normally made by trade flows between the member countries, which enable situations of temporary divergence to be brought under control under normal conditions. It would be very liable to impede the optimum orientation of capital flows within the Community. It would have adverse effects socially, especially for migrant workers. And psychologically it would be highly prejudicial to the confidence in the Common Market currencies that is necessary if the Community is to work as it should and to function as a centre of stability.

9. The principle of flexible exchange rates must therefore be ruled out; what is needed is a system of stable rates — a system which is bound to involve constraints, but which must be accompanied by the development of joint policies, joint courses of action, and joint means of intervention, with the focus on the progressive establishment of an organized monetary association with fixed internal parities.

Within this entity, the process of adjustment will depend on alignment of scales of economic priorities and of economic policies in the various countries, ensuring adequate compatibility of economic and monetary trends. As

compatibility will take some time to achieve, short- and medium-term monetary co-operation machinery should be set up to enable individual Member States to deal with any payments difficulties caused by chance factors or market movements. This was, incidentally, the course advocated in the Commission's proposals to the Council in February 1969.

Should more radical imbalances appear before compatibility is secured, parity changes could not be altogether barred, but would be regarded as permissible only in the last resort, and by joint agreement. At all events it is in the Community's interest that the parities between the currencies of the Member States should be fixed once and for all at the earliest possible date.

E. Monetary unification and the international monetary system

10. As the Community advances towards economic and monetary union, it should emphasize its own individuality within the international monetary system, while not ceasing to belong and to contribute actively to that system.

11. This involves the consistent adoption, forthwith, of joint positions in the international economic organizations.

This need is likely to arise in the near future in the IMF, where relaxation of the rules of operation of the international monetary system is now under study. Should the outcome be a broadening of the ranges of exchange rate fluctuation, it is of the greatest importance that the present limits as between Community currencies should *not* be extended.

Also, changes in the IMF Articles of Agreement in conjunction with the creation of the Special Drawing Rights offer the Community opportunities within the international monetary system which it should certainly take, more particularly with regard to the joint management of exchange reserves.

12. Secondly, it would be well to consider progressively reducing the spread of the exchange rate as between the Community currencies.

For it is not desirable, in an economic and monetary union in process of formation, that the maximum variations in the rate of exchange between member countries' currencies should remain twice as great as between any one Community currency and the dollar.

Narrower ranges of fluctuation would encourage the Central Banks to concert their interventions on the exchanges, and to employ the Member States' currencies for such intervention purposes.

They would make for better co-ordination of credit policies in the Member States, and offer a basis for the progressive creation of a joint reserve system.

13. A first reduction in the ranges of fluctuation, bringing the maximum disparity in the spot rates for any two Community currencies from 1.5% to 1%, should not pose any great problem in exchange relations between member countries. It would not unduly affect the freedom of movement the Central Banks wish to preserve with regard to interest rates for reasons of market policy, particularly as the Central Banks tend in any case at normal times not to make full use of the range available. Since the reduction would come at a time when the Community had already begun to act on the quantified medium-term guidelines laid down in the Third Medium-term Economic Policy Programme, it would not rate as a separate monetary measure unconnected with the co-ordination of economic policies in the Community.

14. While there is thus no reason why the ranges of fluctuation should not be reduced at an early date, it would not be feasible to go on from there to do away with them altogether: for so long as convergence of economic policies is not adequately secured, exchange relations between the member countries should be left to some extent flexible. For this reason, the Commission would suggest holding over any further narrowing of the fluctuation ranges until later. By the time the Third Medium-term Economic Policy Programme has been fully implemented in 1975 it should be possible to assess whether the effects on the movement of the Community economy justify a second reduction.

F. Desiderata

15. To achieve economic and monetary union without undue delay, it is important to avoid dispersal of effort. Accordingly, a choice will have to be made of the fields in which action is called for, and of the forms which the action is to take.

It is necessary therefore to decide which of the various fields of Community activity are of strategic importance internally and externally. In the Commission's view, there are four such fields.

- (a) Medium- and short-term economic policy, monetary policy, budgetary policy.

The object here must be to seek to ensure adequate compatibility of the movement of the Community countries' economies by framing more and more closely co-ordinated policies. Medium-term policy should establish the basic conditions for compatibility, in the light of the quantified guidelines for the main economic aggregates; short-term policy should outline what action can best be taken to keep the movement of the economies within acceptable compatibility margins. Monetary and budgetary policy, by which the weapons of economic action are wielded in practice, should be conducted on lines consistent with the medium- and short-term objectives laid down.

(b) The Community capital market.

A capital market must be progressively built up as a counterpart to the market in goods already established in the Community, to aid the Community's industrial development by optimum allocation of savings as between investment needs, and end the situation whereby the international capital market plays a preponderant role in the distribution of savings accumulating in the Community countries.

(c) Taxation.

Here the aim must be to achieve the harmonization needed for the economic and monetary union to function successfully. Two important cases may be mentioned specially:

- harmonization of the rates of tax on value added, so as to ensure the completely free play of competition and full freedom of movement of goods within the Community, and to encourage better combinations of the factors of production. Some scope for variation either way from the rates adopted could be allowed, more particularly in order to enable indirect taxation to be used to some extent, where appropriate, in short-term economic policy;
- harmonization of certain types of tax having a notable influence on capital flows would also appear to be called for in connection with the development of the Community capital market.

(d) Strengthening monetary solidarity to make the Community an individualized and organized unit within the international monetary system.

THE STAGES

In accordance with the principles set forth above, the Commission has endeavoured to work out the different stages to be envisaged in the process of instituting economic and monetary union.

The "time horizon"

16. The steps leading up to economic and monetary union must be taken in relation with a "time horizon" enabling the scale and timing of the measures to be carefully planned.

The Commission considers that 1978 could usefully be taken as a rough guide.

This is the scheduled date for full Community self-financing. Moreover, it may be fairly close to the end of the transition period which, if the negotiations for membership are successful, could usefully be laid down for the applicant States; progress towards economic and monetary union and the prospect of its achievement would help to enable certain problems liable to arise from membership for the applicant countries to be overcome, and at the same time spare the Community the weakening that might result from its enlargement. Again, eight years is undoubtedly the shortest possible time in which the numerous measures needed to go over from a customs union to economic and monetary union could be put through. Provision would have to be made for deferring the end date, if absolutely necessary, by one or two years.

Stages

17. In relation with the "time horizon", the Commission takes the view that the period could comprise three stages, concentrated respectively on the preliminaries to economic and monetary union (1970/71), the preparations for economic and monetary union (1972/75), and the definitive establishment of economic and monetary union (1976/78).

Adoption of a timetable does have the advantage of not leaving room for undue uncertainty as to how long each stage will take, and of making it an obligation to achieve, within a reasonable space of time, the ends laid down for the Community by the Heads of State and Government. Nevertheless, the timetable must be kept sufficiently flexible to allow of effective adjustment to operational requirements.

A. — First stage (1970/71)

18. The Hague communiqué states that the plan in stages for economic and monetary union must be based on the Commission's memorandum of 12 February 1969. All the steps urged in the memorandum must therefore be taken in the first stage.

The following measures could usefully be adopted during this period.

19. *With regard to co-ordination of economic policies:*

(a) Adoption at the end of 1970 of the Third Medium-term Economic Programme, with quantified guidelines and structural measures; approval of procedures for implementing the Programme in line with short-term economic policy.

(b) More effective co-ordination of short-term economic policies, with the aid, in particular, of an "early warning system".

(c) From 1971, annual confrontation of member countries' budget estimates at Minister of Finance level.

(d) Preparation of medium-term guidelines on budgetary policy.

20. *With regard to capital markets:*

(a) Adoption of a third directive on action to intensify the interpenetration of the money markets of the Member States.

(b) Setting-up of an *ad hoc* working party of the Monetary Committee to confer regularly on capital flows within the Community:

(c) Adoption of tax harmonization measures with respect to interest, dividends and the structure of corporation tax.

21. *With regard to taxation:*

(a) Introduction of tax on value-added throughout the Community, and adoption of a programme for approximating TVA rates.

(b) Adoption of a programme for harmonizing excise duties.

22. *With regard to strengthening monetary solidarity:*

(a) Institution of medium-term financial assistance machinery, involving use of SDRs.

(b) Concertation on Member States' credit policies in the Committee of Governors of Central Banks.

(c) Systematic application of procedures enabling the Member States to act as a single association in the international monetary organizations.

(d) In the event of alterations in the exchange rate system at international level, establishment of uniform rules for the Community as a group and retention of the present fluctuation ranges for the Member States' currencies.

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It should be possible to take all these decisions (some of which are already being examined by the Community authorities) in the course of the next eighteen months.

B. — Second stage (1972/75)

23. The second stage, which will be decisive for the outcome of the whole venture, would be devoted mainly to ensuring convergence of the general movement of the Member States' economies and making a start on the creation of a single monetary entity. Action to this end would come partly within the terms of reference of the Third Medium-term Economic Policy Programme.

24. *Co-ordination of economic policies:*

(a) Joint establishment of the main lines of overall economic policy, to furnish guidance for the decisions to be taken in the different fields.

(b) Annual examination of the economic development of the Community in the light of the medium-term quantified guidelines, and use of "sliding projections" to update the latter.

(c) Putting in hand of the structural measures provided for in the Third Medium-term Economic Policy Programme.

(d) Joint fixing of the short-term economic policy guidelines, so as to make sure that they are properly in line with the Community's medium-term guidelines.

(e) Joint establishment of budget policy guidelines with respect to main revenue and expenditure headings and to procedures for financing deficits.

(f) Use of similar weapons of budgetary policy by the Member States to promote better control of business fluctuations in the Community.

(g) Regular examination, as part of a procedure for consultation with the two sides of industry and other bodies representing particular economic and social forces, of the broad outlines of economic, fiscal and monetary policy and of any decisions concerning more directly such bodies.

25. *Capital markets:*

(a) Gradual improvement of arrangements enabling member countries to gain access to the capital markets of other member countries.

(b) Harmonization of rules governing the status of financial intermediaries (especially institutional investors) and the operation of the stock exchanges.

(c) Utilization, on terms to be settled later, of a Community unit of account for the issue and circulation of credit certificates negotiable on the money and capital markets of the Community.

26. *Taxation:*

- (a) Progressive harmonization of TVA rates.
- (b) Progressive harmonization of excise duties.
- (c) Harmonization of tax arrangements encouraging certain types of investment.
- (d) Harmonization of corporation tax as to structure and basis of assessment.

27. *Monetary solidarity:*

- (a) From the beginning of 1972, limitation of spot-rate disparities between member countries' currencies to 1% and introduction of a policy of concerted intervention by the Central Banks in the exchange market.
- (b) Preparation by the Committee of Governors of Central Banks of credit policy guidelines related to the guidelines for general economic policy at Community level.
- (c) From the date of the new allocation of Special Drawing Rights in 1973, joint management of Member States' SDRs.

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28. On the completion of the second stage in 1975, the Council would review the overall Community situation and assess whether this justified going on to the definitive establishment of economic and monetary union.

The Council would be free to decide, should the Commission so propose, that transition to the final stage should be deferred. This deferment could not exceed two years.

C. — Third stage (from 1976 or 1978)

29. For the third stage, only the measures establishing the essential components of economic and monetary union can be indicated:

- (1) Allocation to the Community institutions of the necessary powers for ensuring the smooth functioning of the union.
- (2) Establishment of a Council of Governors of Central Banks, as a step towards the eventual introduction of a Community system of Central Banks.
- (3) Establishment of a European Reserve Fund under the Council of Governors, to which the member countries would divert a progressively larger proportion of their reserves.

- (4) Elimination, in two stages, of the fluctuation ranges for the member countries' currencies, and fixing of the parities without possibility of alteration.
- (5) Establishment of free movement of capital in the Community.
- (6) Elimination of fiscal frontiers.

The conditions governing the introduction of a single European currency would then be fulfilled.

CONCLUSION

30. Alongside the moves towards economic and monetary union, measures will have to be taken to strengthen the Community institutions economically and financially.

The Commission feels it would be premature to specify the reforms to be undertaken in this connection before the details of the plan for unification by stages have been settled.

The Community's present armoury, if properly used, should suffice for the first stage of the plan.

As the implementation of the plan proceeds, however, the weapons to hand will need to be improved and new ones added in preparation for the point when, in the final stage, the institutions will be vested with all the powers required for the economic and monetary union to operate effectively.

Here, as in all other matters dealt with above, the Commission takes the view that a gradual approach should be adopted, in order to retain as much as is useful in the present arrangements as possible while ensuring that steady progress is maintained towards economic and monetary union.