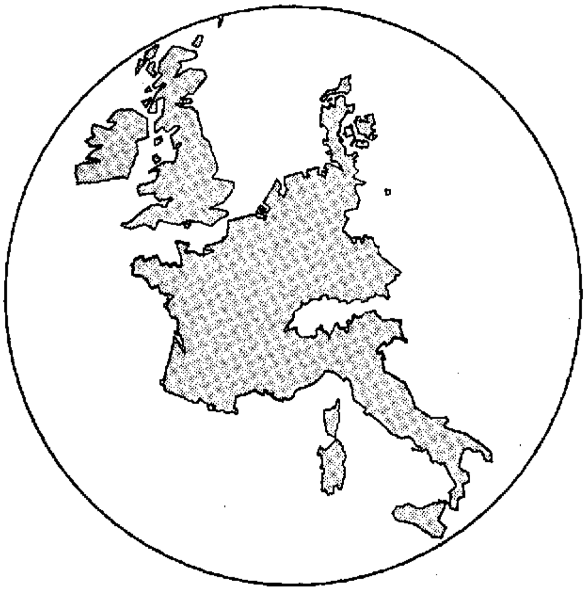
The Magnifico Report (Brussels, October 1973)



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European Economic Integration and Monetary Unification

Intégration économique européenne et unification monétaire

Integrazione economica europea e unificazione monetaria

Europese economische integratie en monetaire unificatie

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STUDY GROUP ON ECONOMIC AND MONETARY UNION

EUROPEAN ECONOMIC INTEGRATION AND MONETARY UNIFICATION

P R E F A C E

Towards the end of 1972 the European Commission asked several experts distinguished in the field of economics, to examine the possibilities and means of achieving Economic and Monetary Union.

This Study Group has held several meetings in which officials of the Commission also took part. The meetings have given rise to profound discussions. In view of the great interest of the ideas put forward by this Group it has seemed useful to make them available to the general public.

The present document consists of two parts. The first part presents a report written by three r a p p o r t e u r s of the Study Group (Professor Dosser, Professor Magnifico, Professor Peeters), acting in a personal capacity. The views they have expressed here do not necessarily represent those of the institutions with which they are associated. During the preparatory stage the Reporting Group also profited of valuable contributions of Professor Neubauer. This first part commits only the three members of the Reporting Group. It reflects the work of the whole Study Group in that it summarises and synthesises the main views of the majority of the Study Group members, though not all of the members of the Study Group would agree with all of its main conclusions. Any such differences of opinion are reflected in the individual contributions of the members of the Study Group which are published in part II. These contributions have served as a basis for the discussions and for the drawing up of the report. They also permitted members of the Group to express more personal opinions on particular points.

Taking into consideration the circumstances, the monetary aspects have been especially emphasized. The Group has not considered all implications of Economic and Monetary Union, since the study aims rather to encourage further discussions than to spell out definite positions.

The Commission expresses its gratitude to all members of the Group who have given considerable support to the analysis of specific problems posed by Economic and Monetary Union. However, the Commission emphasizes that the publication of the results of these considerations in no way implies that the Commission is at all committed to any of the conclusions stated in the report.

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PART I

SYNTHESIS

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- SYNTHESIS -

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EUROPEAN ECONOMIC INTEGRATION AND MONETARY UNIFICATION

INTRODUCTION

At the Hague Summit on 1 and 2 December, 1969 it became the ultimate declared goal to establish an Economic and Monetary Union (EMU). EMU was put forward as the next essential step in the process leading towards European economic and political integration. Underlying this move was the hope of preserving Europe as an island of stability and freeing it from outside shocks. During the following years, the apparent difficulties of the international monetary system and its recurrent crises made the need for agreement among the Community countries to step up their efforts for economic and monetary unification more urgent.

The rationale for progress toward monetary unification and economic integration, however, derives as much from internal as from external Community preoccupations. Monetary unification has always been considered as a logical and necessary step on the road towards full economic union. Repeated currency crises since 1967 only shifted the emphasis from internal preoccupations towards a more externally oriented approach. Whereas internal Community building was the major driving force which inspired the proposals for monetary unification antedating the Werner report, it is Europe's position vis-à-vis the outside world, and the related loss of control over monetary affairs for internal stabilisation purposes, which originated the major impetus in more recent years.

Although the importance of monetary unification cannot be challenged, it is at the same time important to realize that the integration of national currencies and national monetary systems into a unified European system is only one element of the general European integration process, economic and politica

A monetary union of the Nine is by no means an objective in itself. Money should be kept as a good servant; it must be prevented from becoming a (potentially) dangerous master.

Nevertheless, one current of opinion argues that priority be given to monetary unification. Progress towards economic union (common policies with regard to business cycles, economic growth, distribution of incomes, social affairs, competition, etc.) is then considered as having only the function of safeguarding the measures orientated towards monetary union. The contrary opinion believes that priority for monetary unification might be more to the detriment of the integration of economic policy and policy objectives than to their benefit. According to this view priority should be given to economic union which is to be advanced and safeguarded by measures of monetary unification. Substantial progress towards economic union would create the necessary conditions for further development in the field of monetary union.

To the extent that an adequate understanding of the required "function of safeguarding" in either the economic or in the monetary sphere is developed, both points of view do not differ very much. Both opinions converge towards the real economic and political meaning of "the principle of parallel progress in the various fields of Economic and Monetary Union" reaffirmed at the Paris Summit.

The point to be stressed is that the postulate of parallelism is not only a political compromise between originally conflicting interests. It is rather the consequence of the interdependence of economic processes. Hence the principle of parallel policy may also be interpreted as requiring an integration policy of broad-ranging interdependent measures.

It is within this general framework that the particular measures aiming at merging the Nine towards an Economic and Monetary Union are to be judged. Whilst the political motivations underlying this process will not be elaborated on in this report, the ultimate motivation for European integration is political and perhaps it is this political determination which explains why the governments of the member states accepted (The Hague 1969) and reaffirmed (Paris 1972) the principle of economic integration and monetary unification, even if apparently all the consequences are not always fully understood or agreed upon. This report addresses itself to the economics of EMU and tries to contribute to the difficult task of showing how this political decision can be translated into an economically meaningful and operational scheme.

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This report has not dealt with the implications of EMU for the international monetary system and vice versa. This might appear rather surprising at a moment when negociations for a reform of the international monetary system are under way. However, for the near future only transitional regulations may be expected, which will probably remain the subject of experiments and further changes. Therefore, efforts at the European level cannot start from anticipating this reform. One thing, however, is clear : as matters stand now development in monetary affairs tends towards increasing the importance of regional monetary zones. In addition and perhaps more important, both problems are sufficiently distinct to be analyzed separately at this stage. Of course, proposals for progress of EMU can affect the rules and the working of the international monetary system but without modifying the fundamental issues at stake. Besides, it is the official position of the Community countries in the current monetary negociations that the proposals for reform should not interfere with European attempts towards EMU. This taken into consideration the Group believes that dealing with monetary unification at Community level presents also a contribution to the reform of the international monetary system.

Part I of this synthesis surveys the major issues underlying the process towards monetary unification and economic integration. Part II is devoted to the main technical problems and proposals for monetary unification including the introduction of a Common European Currency (C.E.C.) (1). Part III reviews the possibilities and necessities for action in the broad field of economic and social policies. Final remarks summarizing the major policy conclusions are set out at the end of the report.

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(1) To avoid possible confusion or too strong indentification with analogous proposals for an early introduction of a European currency it was preferred for this report to stick to the neutral and uncommitting expression of a "Common European Currency" instead of using the much more loaded name of "Europa" (or other names suggested so far).

I. The Economics of Monetary Unification and Economic Integration

Although a full assesment of the costs and benefits of monetary integration can hardly be worked out at his moment, this part of the report is focussed on the arguments for monetary unification on the one hand, and the necessary qualifications and drawbacks on the other. The first section is devoted to further comments on the need for parallelism between monetary unification and economic integration.

A. Monetary Unification as part of Economic Integration

Parallel progress towards monetary unification and economic integration is vital. It is neither a matter of compromise nor a matter of principle. The following considerations are intended to substantiate this point.

A succesful completion of monetary unification in Europe will depend on the ability of the governments of the EC-member countries to reconcile balance of payments equilibrium with full employment at stable prices during the transitional period when the process of economic and monetary integration reduces available instruments and/or the autonomy of using them. Autonomy of national economic policy objectives and the lack of homogeneity of attitudes in particular towards the trade-off between unemployment and inflation are at the origin of the familiar external adjustment problem which has been plaguing the functioning of tho international monetary system for more than a decade now. It is also the central issue in the process of creating a monetary union.

The implications of monetary unification for the member countries are twofold. They will (gradually) surrender autonomy (1) in internal monetary policy, and in exchange rate policy. However, it is open for debate how much sacrifice of autonomy this may entail. The present degree of integration of world financial markets already imposes severe constraints on the freedom of individual countries. The current exchange rate arrangement with certain currencies floating individually may be considered, among other reasons, as an attempt to avoid the constraints imposed on monetary policy by integrated financial markets. However, it will hardly be a lasting solution (cf. part II).

(1) It may be useful to recall at this point that the member countries have already given up trade policy at the national level for external adjustment purposes as a result of the achievements of the Common Market so far.

Monetary unification, based on the introduction of a Common European Currency along the lines presented in this report, offers the major advantage that it will help to restore at the European level the efficiency and independence of monetary policy for stabilization purposes which the national central banks have lost to a large extent without sacrificing sufficiently stable, though still adjustable, intra-Community exchange-rate relationships. However, the creation of a Common European Currency is no deus ex machina. It is important to underline that the effectiveness of the proposed scheme for monetary unification depends crucially on the creation of an adequate European decision taking process in monetary matters. To the extent that this will be achieved it is not only an important contribution to monetary unification, it will constitute at the same time a great step towards economic integration and policy harmonisation.

If monetary unification is not to be separated from economic integration, there is a fortiori no point in dealing with monetary integration policy as if the problems of a Common European Currency, of exchange rate policy and capital movements (external monetary policy) could be dissociated from the problems of monetary policies within the member states (internal monetary policies). The integration of external monetary policy is bound to fail if the integration of internal monetary policy does not progress pari passu. It is perhaps one of the major shortcomings of the current Community exchange rate arrangement (the snake) that it is not sufficiently supported by common action in the field of internal monetary policies.

If controls of capital movements according to the requirements of monetary integration were abolished whilst at the same time autonomy in national money and credit policy was maintained, the danger that divergent monetary policies might lead to serious difficulties would be amplified. The Fund for European Monetary Cooperation would be solicitated beyond its capacity and thereby be brought into discredit. Parity changes not justified by the state of economic transactions in goods and services would be provoked and conjunctural policies upset in member countries only passively involved.

The process of exchange rate unification and capital market integration implies that monetary policies of member states, external as well as internal, should be increasingly linked together. Priority should therefore be given to the process of harmonization of monetary instruments ultimately leading to an identical set of instruments. This process would be useful and necessary even in the case where national money and credit policy remains independent in the near future. As matters stand now, it is extremely difficult to assess the comparative effects of measures of monetary policy in the individual countries (1). Thus the coordination of these measures is hampered. Undoubtedly the unification of monetary instruments is rendered difficult by considerable differences in the structure of the banking sectors and in the business behaviour of banks in various countries. Nevertheless it is an important goal to develop a common set of instruments which permits (a) a direct regulation of bank liquidity, (b) direct influence on market interest rates and (c) credit ceilings as an emergency brake for restrictive monetary policy. The creation of a common European central banking system would thus be prepared.

Meanwhile monetary authorities in the Community will have to implement a common European liquidity policy. Decisions on variations of bank liquidity and its control at the European level and not at the national level is indeed the key issue (2). This must not imply the adoption of a strict quantity rule for money supply, neither should it be interpreted to imply the same rate of increase in bank liquidity in each member country. The concept of a European liquidity policy could aim at setting limits (possibly nationally differentiated) for money base creation, leaving it to national authorities to utilize their discretionary power according to the commonly agreed band as well as the choice of channels and instruments

(1) Reference to Communautés Européennes, Comité monétaire : La politique monétaire dans les pays de la Communauté économique européenne. Institutions et instruments, 1972.

(2) The practical implementation of this policy presupposes the production of more comprehensive European monetary statistics in which the foreign liabilities of the European banks to Community residents (the so called Euroliquidities) are included in European liquidity.

through which to implement the specified goals. The point to be stressed is that these steps towards monetary integration should not be dissociated from the development of an independent common decision-taking body in monetary affairs.

Parallel progress towards economic integration and monetary unification is natural and necessary for other reasons also. Monetary unification, for instance, critically depends on the ability of member countries to preserve external balance without upsetting progress towards exchange rate unification and capital market integration. The task assigned to economic integration in this respect is to avoid chronic disequilibria between member states. Economic integration in the sense of policy coordination and harmonization is one of the ways to cope with the external adjustment problem by trying to avoid disequilibria from occurring at all. Success in economic policy integration would make intra-Community exchange-rate adjustments superfluous and monetary unification possible.

Finally, it is to be stressed that monetary unification is only instrumental in achieving certain aims better than would otherwise be possible. Monetary unification, important though it is, is subordinate to overall socio-economic policy objectives. It cannot be conceived of as feasible outside the wider context of economic union. It belongs to economic union just as other instruments of economic and social policy do. In the Paris summit communiqué it is stated that :

> "Member countries are determined to strengthen the Community by setting up an economic and monetary union as a guarantee of stability and growth ... Economic growth, which is not an end in itself, must in the first place be aimed at reducing disparities in living standards. It must improve ... the quality and level of life".

The objectives of economic integration are broader than those of monetary unification. They imply that monetary unification should be pursued in a fashion consistent with a European policy of balanced growth as a condition for improving "working conditions and conditions of life". To secure an even pattern of high employment of resources and to close the gap in living and working conditions throughout the union's territory, conscious policies at the Community level, reaching beyond the technical problem of an operational scheme for monetary unification, should become an integral part of the efforts undertaken along the road towards economic and monetary union.

It would be a rather unfortunate development if the efforts for progress of the European construction in the near future would be directed almost exclusively towards monetary unification and its related problems. This is not to deny its importance and the difficulties involved. Nevertheless, there remain outside the monetary domain a number of fields where centralized European action is worth-while and desirable because it enhances the economic welfare of the individual citizens.

Continuous action which promotes the efficient use of resources by making the best of the virtues of the market mechanism in equating social costs and values at the margin includes the abolition of different artificial government restrictions still impeding the free flow of goods, services and factors of production, not only between the European countries but also vis-à-vis the rest of the world.

Structural problems due to economics of large scale production cutting across national borders of a concentrated area like Europe also call for centralized European action. Common industrial policies and regional planning are illustrative cases. The appropriate scale for the procurement and consumption of public goods such as environmental protection or research and development efforts may well be European rather than national.

However, with the greater degree of economic integration in the Community achieved through freedom of trade and factor movements, the need for centralized coordination of overall monetary and fiscal policies for the purpose of stable economic development in member countries will also increase. These aspects are dealt with in greater detail in part III of this report.

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B. The Need for European Monetary Unification in the Framework of Economic Integration

A distinction should be drawn between the actions and the ultimate objectives to be achieved in the monetary and the economic field. Whereas monetary unification has a clear aim and can be given a precise content, economic integration is wide ranging and open ended. For the latter it is impossible to define some end-point, since this itself would raise acute differences of opinion as to the degree of centralism or federalism eventually to be attained by the Community economy. The process of economic integration may be fast or slow; the declaration of parallelism between monetary and economic union (1) sets a certain minimum required pace along-side monetary unification, but over and above that, there is scope for a great deal more fruitful advance, as outlined in the previous section, if member-states have the political will.

Achievement in economic union during this decade may prove to be more difficult than in monetary union, in view of the varying degrees of fundamental changes involved in the centralization and decentralization of various economic functions. But, because of that very fact, such progress represents a more profound movement in the creation of a unified Community economy; and since it affects people's jobs, lives and environment directly, it carries tremendous importance in determining their opinion of the Community.

In both cases, however, it is important to draw a distinction between integration as a process or as a state of affairs.

Indeed, it is not too difficult to argue that monetary and economic union (the final stage) must be considered an impossibility under present circumstances. This, however, is not sufficient to claim that it is also an impossibility for the future, when conditions can be changed as the result of concrete policy action. From a policy point of view it is, therefore, only sensible to speak about European economic and monetary integration in terms of a dynamic process of change. What this process involves in the monetary and the economic fields is different. That is why this report prefers to speak about monetary unification and economic integration.

(1) Reference to Paris Summit Communiqué

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The motivations for monetary unification in the framework of economic integration derive from the need to consolidate and expand the European construction (internal reasons) and to restore control over monetary affairs in Europe (external reasons).

1) Internal reasons

The eventual realization of monetary union follows the logic of European economic integration based on the free movement of goods, services and factors of production among the member-countries. Freedom of payments for transactions connected with trade in goods and services is necessary as a complement to a customs union if in intra Community exchange, conditions analogous to those prevailing in national markets are to be created. The free movement of capital, an essential component in the construction of a unified European market, depends ultimately on full convertibility for capital transactions. Free transfer of capital also avoids an artificial dividing line between current and capital account transactions. It excludes the possibility that capital controls interfere with the freedom of exchange of goods and services. Indeed it is an empirically observed fact that controls on capital transactions gradually extend to current account transactions, tourists generally being among the first category to be hit together with measures to control leads and lags in payments for trade transactions. A monetary union, characterized by complete and irrevocable convertibility and by rigidly locked intra-Community parities with no margins of fluctuations among the currencies of the union, is a guarantee for the free movement of goods, services and factors of production.

The final logic of the convertibility feature of the projected European economic and monetary union is seldom disputed. On the other hand, the question whether exchange rate unification would be helpful during the transition has been and is much more controversial. Alternative exchange rate arrangements going from floating rates to completely rigid exchange rates among member countries or a common currency, do permit, it is argued, the realization of the advantages of specialization and mass production. What matters, according to this view, is solely the abolition of obstacles to the movements of goods and factors of production, not a common currency or a permanent fixing of exchange rates.

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The major trouble with this view of European economic integration is that it overlooks the internal dynamics of a process which is intended to reach beyond a customs union and the simple freeing of the movements of goods, services and factors of production. The objective is to create among the member countries, conditions that will remove any bias against intra-Community trade and factor movements relative to trade and factor mobility internal to countries.

To "internalize" intra-Community trade, progress towards economic and monetary union is needed in order to spare the industrial customs union the jolts of exchange rate jumps and the implied threat for competitive efficiency. It will also contribute to preserve parts of the agricultural policy, although the latter should not be allowed to act as the tail wagging the dog. Even if the C.A.P. is overhauled, making fixed parities less important from that point of view, there are still many other important advantages, for example, efficiency gains due to the simplification of transfers, the elimination (or reduction) of exchange risks and the abolition of internal exchange controls.

Monetary unification becomes even more pressing when one turns to intra-Community liberalization of capital movements. Indeed, freedom of capital movements will bring about an equalization of interest rates on the Community's money and financial markets. This robs the national monetary authorities of one of their major instruments for domestic stabilization purposes i.e. interest rate policy. Unification of the Community money and financial markets is far from complete. Nevertheless, the *de facto* integration which has developed as a result of the expansion of the markets for Euro-currencies, already offers sufficient potential for destabilizing short term capital movements in anticipation of exchange rate variations and/or as a reaction to interest rate differentials.

If anti-cyclical policies through monetary control other than interest rate variations are difficult in implementation at the national level in the short run, because of the degree of integration achieved, it is necessary to replace the national instrument by a community instrument. It might be objected that this is only one possibility.

Another possibility to escape from the dilemma, would lie in greater flexibility in exchange rates. The latter solution, it might be argued, would recreate at the national level the opportunity for an efficient and independent monetary policy.

The issue involves basically the long-standing controversy over fixed versus flexible exchange rates and the more recent formulation of that issue in terms of the economics of optimum currency areas. Whereas extreme positions in both directions do not offer practical solutions, it is admitted that during the transitional period some form of intra community exchange rate flexibility, as outlined in part II, will be necessary.

Still to be mentioned as an element of internal Community building is the fact that progress towards monetary unification offers perspectives for a convenient Europe-wide unit of account and medium of exchange. This development would strengthen, inter alia, the economic position of European banking, business, and financial firms by offering them an instrument comparable to the dollar together with the benefits from the economics of scale and the diversification of services which only a unified European monetary and financial market and a widely spread currency, can offer.

A common European currency would also recoup the seignoriage now accruing to US banks and tax payers.

2. External reasons

Until recently (March 1973) developments were such that Community countries had become commercially integrated with one another, whereas monetarily they communicated mainly with, and through, the dollar. This caused sharp conflicts at a time when the trade cycles were tending to diverge on the two sides of the Atlantic. Already in the second half of the fifties, Europe had regained autonomy vis-à-vis the United States in the trade cycle, but, more or less up to the end of 1972, this did not hold in the monetary and financial spheres. Several factors (including, of course, the growth of the Eurodollar market) accentuated monetary interdependence. Given the great disproportion between the United States and the fragmented European national markets interdependence was rather lopsided.

The common floating of eight European currencies (Community and non-Community ones) achieved in the agreement of March 1973, the system such as the "snake" involves, among other things, an attempt to regain autonomy and to safeguard intra-Community relations against the apparent difficulties of the dollar. The recurrent crises at the beginning of 1973 and the expected consequences of the different measures taken by American authorities in order to support the dollar, rendered it impossible for European authorities to rely any longer on the so far achieved de facto rôle of the dollar as the main European reserve and intervention currency. However, experience has shown that the kind of common floating involved in the "snake"-arrangement presents a rather fragile solution. Although it has eased the problems raised by the Eurodollar system, this arrangement has neither been elastic enough to enable all member countries of the Community to participate, nor has it spared the signatory countries the jolts of further parity-change. Therefore a fundamental solution has still to be found. This is all the more true since dollar liquidity has not yet been definitely banned. The more the dollar gains in strength due to the planned development of the American basic balance of payments, the higher is the probability that the dollar will be used again as an intra-Community currency.

Objections against monetary unification are often based on the limitations that it imposes on national sovereignty. This attitude, however, is rather inconsistent with the acceptance of the loss of sovereignty that has arisen or is expected to arrive from the Eurodollar system. Up to March 1973 the situation, where fragmented national money and capital markets largely communicated through the dollar, imposed damaging constraints on monetary policy in Europe. The fact is that not only the control of national central banks over domestic money supplies was increasingly weakened, but the European money supply had become subject to the monetary policies followed by the US authorities.

A common floating set out in the "snake"-arrangement cannot be considered as a lasting solution for the Community as a whole, provision has to be made to prevent dollar liquidity from reappearing. What the Europeans need, and they need it now, is the creation of a substitute for the dollar. This rôle will have to be fulfilled by a Common European Currency tailored to suit the Community needs and which the Europeans would collectively manage for themselves.

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C. Major Qualifications and Drawbacks of Monetary Unification.

Although monetary unification appears to be in the logic of economic integration and is considered as a necessary further step for the European Community, its underlying dangers and possible negative implications ought to be understood clearly. Discussions and scepticism on monetary unification are focussed on possible adverse internal effects. As already stated, countries will gradually surrender autonomy in the use of policy instruments for internal and external balance. If divergences in price - and cost - trends between the member countries persist, this would impose intolerable strains on their economies. Furthermore, the adjustments might take place to the detriment of the weaker regions in the Community thereby worsening the existing regional problems or leading to the formation of new ones. Together with the difficulties which might still arise from diverging business cycle developments, one has to cater for avoiding a rather negative total impact of monetary unification on the major objective of a smooth and balanced growth of the EC-economies.

1) Diverging price - and cost - developments

In the post-war period the task of maintaining internal and external balance has been made more difficult by the fact that the multiplication of economic and social policy objectives has outgrown the range of available effective institutions and policy instruments. This development has increased the possibility of conflicts between objectives and the adequate use of instruments. These conflicts very often resulted in a partial sacrifice of certain goals and/or in a trade-off against other goals. Because the readiness to sacrifice related objectives differs from country to country, as shown by the trade-off between the rates of growth of G.N.P., full employment and price-stability, it is not surprising that discrepancies in national price and cost levels have developed to an extent which often requires exchange-rate adjustments.

As long as the ability to sustain the processes of economic growth in a context of monetary stability differs between member countries, monetary unification must be pursued in a way permitting smooth adjustments of economies via exchange-rate changes. If exchange rates were rigid, countries with heavy cost-rises would register unemployment and deficits in their balance of payments. Countries with low cost-rises, on the other hand, would suffer from pronounced overemployment and increasing inflation.

Furthermore, monetary unification as worked out in particular in part II may contribute to lifting the veil which tends to blur the differences in money wages paid for the same work throughout the Community. To the extent that this would encourage claims for pay parity throughout the Community's territory regardless of differences in productivity, this would add to inflationary pressures and aggravate regional problems.

For all these reasons adjustments of exchange rates cannot be excluded during the transitional period towards E.M.U. At the same time they point out that if these adjustments are to be kept within a small margin, an appropriate flexibility and medium term coordination in the development of national cost-levels and prices will be indispensable. In other words, measures ought to be taken in the field of incomes-policy and/or budget policy (cf. part III).

Divergencies in prices and costs do not only require further approximation of trends between member countries. They may also give rise to particular problems in the short run, because of divergent cyclical movements. The evidence whether there is a tendency for greater convergence in intra-Community business cycles leaves room for debate. Nevertheless, progress in the liberalization of movements of goods, services and factors of production can only be expected to bring about this convergence via increasing intra-Community economic interdependence.

During the first stage of E.M.U., divergences in business cycles have been more or less dealt with by means of exchange rate fluctuations within the margins. However, if these margins were to be narrowed the success of monetary unification will also depend on how far an adequate synchronization of business cycles occurs as a result of developments in the private and public sectors, since the prospects for adjustments of divergences in member states as monetary unification proceeds, will be limited.

In part III, fiscal policy for stabilizing business cycles are discussed. As regards monetary policy, it follows from the foregoing that monetary stabilization policy will have to be pursued mainly at Community level. With this shift of policy competence, business cycles will have to be kept synchronized. Otherwise it would not be possible to pursue a restrictive or expansionist monetary policy at Community level, aiming at influencing total demand, since the problem would be posed as to how to treat regions or countries experiencing a boom in relation to others suffering from a depression. And even if a policy in favour of one category of region were followed, the measures taken would hardly lead to the expected effects : low interest rates would rather tend to stimulate the boom than to moderate the depression and vice versa. It is clear that under such circumstances reliance on monetary policy as the sole or, at least, the major anticyclical instrument would lead to disappointing results. Summing up, the approach towards the final stage could and perhaps should be a more flexible one, providing selective means to cope with remaining regional cyclical divergencies, which could not be dealt by the envisaged exchange rate margins.

However, synchronized business cycles, although facilitating the task of a European monetary policy at the final stage of EMU, would not necessarily eliminate all difficulties. Special measures, for instance in the field of fiscal policy, still largely the responsibility of member countries, could upset Community action. An exaggerated use of policies beyond the differentiations justified by structural gaps between countries, would lead to unjustified disadvantages for obedient countries. To avoid such conflicts a sufficiently concerted short term policy would be the appropriate remedy (cf. part III).

2) Regional and structural imbalances

Progress towards monetary unification will put heavier pressure on economically weak regions in relation to the stronger regions of the Community. In national states weak economic regions, economic sectors or social groups usually constrict considerably action available for economic measures, when steps against an excessive boom in order to stop excessive costs and price increases are desirable. It always appears attractive to remedy regional and structural unemployment by means of general demand-management policies. The limits imposed on national demand-management policies as due to the progress in monetary unification can worsen this particular problem.

Factor mobility can offer a way out of this impasse, at least to a certain extent. A distinction has to be drawn between mobility of labour and of capital. As regards labour mobility, experience has shown that the movements of the labour force taking place at the present time has given rise to severe social difficulties. Housing, health, and retraining facilities are some of the major problems which have not yet found a satisfactory solution. A further increase in labour mobility in order to reduce regional and structural imbalances would lead to unacceptable costs, economic as well as social and psychological. Therefore this cannot be considered as an acceptable solution.

Capital mobility will be stimulated as convertibility is introduced and intra-Community capital controls are abolished as a result of monetary unification. Unfortunately, although capital is in general much more mobile than labour, its potential for automatic adjustments is probably as limited as that of labour migration. There is even an opinion that capital mobility responding to market incentives might, on balance, operate in a perverse way. This qualification should be born in mind when it is argued that unhampered mobility of goods and labour and free capital-movement would promote fullest efficiency in the allocation of resources, and hence would support an

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acceleration of real economic growth in the integrated area as a whole. It is also argued that free capital movement would increase the interaction of investments between member states and thus favour a swifter diffusion of technical innovation. According to this view it is conceivable that monetary unification will stimulate entrepreneurs to transfert capital into regions suffering from unemployment; new industries would replace old ones in decline.

These possibly favorable effects have to be balanced against the negative ones of capital movements flowing from the weaker underdeveloped to stronger industrialised areas. According to some experience, unhampered mobility of capital will attract investments to the regions which offer the highest return i.e. the regions of highest productivity and lowest relative costs. Savings will thus be drawn away from the weak regions, thereby widening the overall imbalance.

Summing up, free factor mobility may intensify the tendency for agglomeration in the already overcongested highly developed regions of the Community, even if it may lessen the interregional adjustment problem. Regional and structural policy including ~~t~~taxation policy, public investments and administrative measures at Community level aiming at the creation of jobs in the depressed or underdeveloped regions should therefore support the process of monetary unification.

II. Monetary Unification and a Common European Currency

Monetary unification in the Community has so far been pursued mainly through attempts to reduce the room for changes in intra-group exchange rates. It was thought that the progessively stringent application of this approach would lead over a decade to the merging of the existing national currencies, and thus place monetary union definitely beyond the point of no return. Experience has shown, however, that in conditions of monetary disorder, both domestically and internationally, the difficulties involved in freezing exchange rates increase at least as much as disorderly money and exchange markets re-awaken the yearning for stability. The difficulties are not only technical in nature. They have a deeper significance, in so far as they reflect conflicts attendant upon the economic, social and political changes which are taking place within and between countries. When the difficulties met are looked at in this light, an approach which attempts at suppressing them sic et simpliciter appears utterly inadequate.

In what follows, an alternative approach is illustrated, which as anticipated in Part I, hinges upon the early introduction of a Common European Currency. This approach to monetary union is in a sense more challenging than the obvious one of just locking the parities of existing currencies together. But, as it will be shown, the Common European Currency would represent technically and economically a powerful factor of unification. This would help to reconcile, with progress towards unification, a limited measure of exchange rate flexibility, which during the period of transition might be found to be indispensable. The introduction of the Common European Currency and the exchange rate discipline here suggested would appear together to represent the path to monetary unification most likely to be helpful in overcoming the basic underlying difficulties.

A. Monetary Unification under Different Exchange Rate Systems

1) Irrevocably fixed internal exchange rates

It is usual for a monetary union to have one medium of exchange in circulation as legal tender, although there are sectors of the economy which assume and discharge obligations also by using currencies other than the domestic one. In countries which are integrated in international money and

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capital markets, transactions in third currencies take place also between residents. Therefore, these countries are no longer, strictly speaking, on a mono-currency standard.

It is also worth noting that in many countries, in the earlier stages of their unification process, there has been more than one type of currency notes in circulation. In general, the plurality of the banks of issue is the feature which has resisted longest the process of unification; it has survived at times also after currencies had been unified in name.

However, historical experience and the current consensus of opinion both suggest that in a fully-fledged monetary union the price of the media of exchange, in terms of one another, cannot vary over space and time. This is a condition which, of course, a mono-currency area meets by definition.

Through the immutability of price of the media of exchange, countries forming a monetary union reap important benefits. The gains may be reaped at little or no macro-economic cost if the constituent economies are fully integrated and are able to utilize fully their productive potential under roughly similar conditions of monetary stability. If the union's currencies do not, and do not need to depreciate (or appreciate) at different rates in terms of the relevant bag of goods and services, there is no need to change internal exchange rates. Therefore, there is no cost in foregoing those changes.

It is very likely that the existing European national currencies will remain in circulation long after the completion of the monetary union, although once the transition was achieved to the final stage, intra-European exchange rates would have to be locked irrevocably together. The maintenance of a multiplicity of monetary symbols meets a deeply rooted European emotional need. With it will survive the multiplicity of issuers, which implies that a minor measure of control over the creation and regulation of the monetary base will perhaps remain with the (peripheral) national authorities. Otherwise, the existence of the various national currencies will hardly have any economic significance.

In order to pay in a European currency different from the one held, only an arithmetical calculation will be needed. This might be simplified by fixing "rounded" exchange rates, such as 10 or 100 units of one currency to 1 unit of another, to which people would grow accustomed because those rates would never

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change. The European monetary union would be truly multi-currency as people and business would receive and make payments in any of the European currencies. The area of circulation of these would no longer coincide with the national boundaries. All member currencies might, in the final stage, be declared legal tender for transactions between residents in any part of the Community.

In fact, the process of interpenetration of national currency domains should be encouraged already now. It would put more pressure on national monetary authorities to harmonize policies, and to harmonize them in the direction of monetary stability, provided one of two of the major member countries were not inflating. But the one hundred per cent locking of intra-group exchange rates will have to wait for the final stage of monetary integration.

2) Freely floating exchange rates

During the transitional period, fully floating exchange rates would be no less inappropriate than complete fixity. If there is a cause of dynamic disequilibrium at work, which at a given rate of utilization of the productive potential for the whole Community, makes costs and prices rise at slightly but persistently different speeds in the different member countries, there is no guarantee that, under freely floating exchange rates, rate adjustments will take place with the graduality sufficient to offset those differences in speed. Even on the more favourable assumption that price elasticities of demand for imports and for exports (produced and exported by several countries), as well as the elasticity of export supply are high in the short run, departures from the equilibrium rates might be more frequent and larger than needed, as a result of capital movements tending to delay, or to anticipate (by different time lengths) the adjustment. The net changes in exchange rates, sufficient to compensate for re-iterative discrepancies in cost and price trends, would be arrived at through wide gyrations. These would in an arithmetical sense largely cancel themselves out, but in the process they would upset money and exchange-markets. They would hamper payments as well as investment planning by business catering for the needs of the Community's market as a whole. They would lead to an overgrowth of the forward exchange markets and to their instability. At the same time, forward cover might not be forthcoming on any terms for some currencies, nor for longer maturities.

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The experience available so far in the case of countries which are floating individually appears to show that decision-taking-bodies and the social partners are by no means less sensitive to exchange-rate changes than to changes in reserves. However, with unlimited recourse to floating rates free rein may be given for carrying out adjustments entirely by means of exchange-rate changes, especially in view in the deterioration in the use of the more conventional instruments of economic and social policy. If the opportunities for integrating the economies, which the transitional period is supposed to afford, are not be frittered away, policy harmonization must have a share in the process of adjustment.

If free floating were to be used as a full substitute for policy harmonization, the ability of member countries correctly to use the more conventional instruments of stabilization and growth policies would tend to differ more and more. The pattern and the processes of allocation of resources in the economies themselves would drift further apart. Moreover, full freedom in exchange rate matters would be inconsistent with the inter-dependance which exists between Community countries as a result of their strong trade integration, which it is now hoped to buttress through more pervasive economic integration. From the technical viewpoint free floating would mean the maintenance of separate national currencies, as in the past exposed to speculation. Freely floating rates cannot be reconciled with the process of monetary and economic integration.

3) Adjustable parities

If during the transitional period, i.e. while conditions of semi-integration of the economies obtain, echange rate changes cannot be wholly dispensed with, the choice lies in actual fact between large parity changes, taking place under (restrictive) supervision by the partners, but unpredictable as to their extend and timing, on one side; and gradual changes, they too supervised, aiming at offsetting cost and price discrepancies due to the different inflationary propensities of the national economies, on the other.

The former method has by and large been applied by E.C. countries and indeed most industrial countries in the postwar period. Experience has shown

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that countries have in fact behaved as if they were not under a fixed rate constraint. Being able to ignore it, also as a result of external balance of payments aid, they lived as if in a world of floating rates, which however were in fact not floating. Therefore, cost and price divergencies were allowed to cumulate year after year, till they made the exchange rate structure hopelessly unrealistic. The d e f a c t o permissiveness of the system not only delayed the adjustment of domestic policies, but also increased resistance to the variation of parities. Devaluations have generally taken place under pressure coming from creditor countries and/or markets. The reluctance of deficit countries to adjust parities did in turn increase the disinclination to adjust on the part of surplus countries, on which the constraint to do so is, as a rule, still weaker. This has led on many an occasion to stalemate situations, which have generated turmoil on exchange markets. Long drawn out political and dimplomatic negociations have been necessary to break out of the impasse. Often the solutions adopted have been scarcely credible. The leadership which it behoves monetary authorities to exert in order to maintain orderly markets has not remained unscathed.

There are several variants in which the system can be operated and improved. The line so far chosen by the Community for the transitional period aims at improving it through a more effective process of policy harmonization; stricter mutual supervision of, and at a later stage Community concurrence in the decisions to change parities, and a prompter adjustment of the latter.

Scepticism in respect of the present EC policy stance seems to be justified by the absence of any new element built into the system itself, which might improve its operation. The improvement should come from a higher measure of political pressure and solidarity, as a <u>deus ex machina</u>. Admittedly, this has been the nature of the causative process behind many historical turning points. But assuming that political solidarity ensured the implementation of the system in the new way envisaged, would this lead to stability and integration?

Mutual supervision and concurrence in decisions affecting parities implies that changes would be made less discretionary. In principle, this is likely to be a contribution to a more orderly and stable system. But, if the decisions to be taken involve large parity changes, would it be a sufficient

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decisions contingent upon Community agreement or the indication of some commonly recognized objective criteria? and besides, how much does it matter to exporters and importers, to industrialists, to bankers, whether the change is made according to some procedure or not, if the size of the change can be as unpredictably large as the changes in the objective criteria themselves? It is the unmeasurable uncertainty which indefinitely large parity changes generate that has really disruptive effects; gives rise to massive waves of speculation that often make the expectations of parity changes self-fulfilling; in the end prevents the full and irreversible liberalization of capital movements. Parity adjustments need to be regulated so as not to deprive entrepreneurs of the stable monetary framework for Community-wide, long-term planning decisions based on profitability calculations with reference to fundamental economic factors. Failing this, the transitional period will not achieve the task for which it is conceived, and the opening and integration of the member countries economies will not advance. Large parity changes between member-states ought to be banned now.

4) Limited internal flexibility and external floating

If there is a consensus, as indeed there is, that parity adjustments cannot be altogether dispensed with during the transitional period, one is left with one possible course of action, which consists in adjusting parities gradually, just as gradually cost and price discrepancies are likely to arise among economies which are now semi-integrated, though poised to move towards full integration. To keep the area of monetary uncertainty during the transsitional period within the limits that would make it manageable for business intending to cater for the needs of the Common Market as a whole, parity changes should only be allowed up to a preagreed size. Changes in any one yearly period should not be larger than a few percentage points. A "flexibility schedule" for parities should be agreed upon at the outset that would lay down the maximum percentage by which parities would be allowed to be changed. It would be expedient to keep those percentages within the current width of the intra-European band. They would be reduced over time in parallel with the shrinking internal band. Thus, given present margins, parity

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changes of up to 2.25 per cent would be allowed in a calendar year; not more than one full change would be allowed to take place in any six months period. However, up till the end of the second stage of EMU, or possibly only midway to it (30 June 1975), exceptions to the "flexibility schedule" might be allowed either in the framework of political decisions to be taken after multilateral consultations, or by shortening the unit period for parity changes as foreseen in the "schedule" from one year to, say, six months.

Changes would, as a rule, be shared by the deficit and the surplus countries. This would be in harmony with the ermerging consensus in favour of more symmetry in the adjustment process for weak and strong-currency countries. It would also reduce for any single currency (deficit or surplus) deviations from the median course. Therefore, it would be less disruptive for capital movements, while obtaining the needed overall adjustment effect. In particular, it would weaken the pull on the Common European Currency by the strongest currency.

It might be objected that it is not realistic to expect member countries to renounce the right to change parities other than within these narrow limits. But the merging of the national currencies implies such a renounciation sooner or later. The whole process will be on much firmer ground if it can be carried out as a gradual exercise, rather than as a dramatic change from a condition of potentially unlimited parity changes to one where suddenly they would no longer take place. If during the transitional period, notwithstanding the progressive rapprochement of the economies and their institutions (including the labour unions), disequilibria should arise, which countries not bound by the programme of monetary union would correct by means of exchange rate changes, the EC countries would have instead to resort to these only to the limited extent allowed by the "flexibility schedule" originally agreed upon. They would have to complete the adjustment by using concomitantly the panoply of instruments that countries on the way to economic and monetary union must have available.

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To secure a use of those instruments coherent with the commitment to the schedule of flexivility, policy harmonisation needs to be upgraded into a discipline for more effective than it obtains in the looser context of international economic cooperation. Institutional arrangements for bringing monetary authorities closer together might be envisaged as a means of fostering harmonisation.

The lack of effectiveness in policy harmonisation would eventually cause the internal exchange rate arrangement to break down. Policy harmonization is, however, a necessary, not a sufficient condition. The defence of a Community exchange rate arrangement also requires pooling the reserves in a <u>meaningful way</u>. In other words reserve pooling, in order to be credible, should not be reversible and should not be based on clauses which would reduce the usability of the reserves by the European Fund for Monetary Cooperation. Usability, and therefore the effectiveness of the Community pool, would be reduced by a clause which made support of a currency <u>automatic</u> within the quota contributed to the pool by the country issuing it, <u>unavailable</u> beyond that quota. Support of currencies should not be related to the quotas, but rather to the merits of each specific case, and to the appraisal of the Community's overall monetary and payments situation.

Pooling the reserves in a meaningful way is necessary because it represents the <u>immediate</u> instrument for pursuing the Community's objectives in the field of exchange rate policy. But, of course, reserve pooling does not have to be total, not even in the sense that one would have to agree <u>now</u> on a schedule for complete pooling. Moreover, different methods would have to be used for each main category of reserve assets, Clearly, under the present constellation of economic and political circumstances, only might be applied to gold a method which would gradually lead to the <u>de facto</u> centralisation of the national gold stocks.

From the opposite side, it might be objected that internal flexibility of exchange rates, even if kept within a few annual percentage points, as laid down in the pre-established schedule, is not conducive to exchange market stability, nor to economic and financial integration. But, as concerns the smooth working of the markets, it should be noted that in order to adjust parities, in accordance with the limited flexibility allowed, no dramatic movements in the rates of exchange would be required. In fact, no change at all of the exchange rate might be needed

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on the announcement of a parity adjustment; only the rate's position in the band would shift. Parity changes would not be larger than the movements in exchange rates which can take place within the band. Those movements can take place quickly, and equally quickly reverse themselves. The fact that in the scheme here proposed changes in one direction would be allowed to cumulate year after year, up to the definite achievement of EMU, would not add to the disturbances which exchange dealers have to face in their daily routine.

On the other hand, the small parity changes provided for under this scheme would be sufficient to give parities the medium-term flexibility that, in the case of economies which are only semi-integrated, is needed in order to lend credibility to the pledge to maintain and defend an exchange rate arrangement. Entrepreneurs would thus be in a position to make assumptions about exchange rate movements within a range of uncertainty and risk that would not cripple the development of Community wide operations.

The exchange rate arrangement here suggested would not hinder the emergence of a European monetary system, as distinct from the world monetary system. The erosion which the concept and essence of a truly international currency has undergone in recent years is one more sign that points to the formation of regional monetary areas. A meaningful common currency seems now feasible only for use within areas possessing a higher degree of socio-economic cohesion and political solidarity.

The lack of an international currency has, as a corollary, that inter-area payments adjustments will have to take place through exchange rate changes. Under an SDR standard large deficit/surplus positions cannot be allowed to develop lest the SDR itself, and therefore the soundness of the standard, should come under suspicion. Given the unwillingness of large countries, or groups of countries, to sacrifice domestic policy objectives to the external ones, when conflicts arise between the former and the latter, inter-area exchange rate changes are bound to have a primary role in payments adjustments.

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flexibility into the joint European float which, as it is, is too rigid for a group of countries that do not comprise yet an optimum monetary area; such currencies can scarcely be expected to behave as if they were one in substance as yet. Internal flexibility would tend to reduce the strains which are bound to develop in the joint float by a large group of countries that are only semi-integrated. Together with the pooling of reserves, it would make the arrangement credible; it would help to break out of the deadlock created in March 1973 when some Community currencies could not join the rigid common float.

In the light of the foregoing, a joint float erga extra cum limited intra-group flexibility appears to be a desirable and feasible compromise between the two extreme positions now obtaining : rigid joint floating on one side and, on the other, free floating outside any provision whatsoever for Community discipline (except as informally self-imposed by the countries concerned).

A formal compromise solution appears all the more appropriate in the light of recent experience. For joint floating is rigid only in principle, while two (small) parity changes in the few months since joint floating started have injected a de facto flexibility in the arrangement, thus prefigurating its evolution towards a type akin to that here proposed.

B. Creation and Role of a Common European Currency

1) The rationale for a Common European Currency

The exchange rate arrangement proposed above would be easier to operate if a Common European Currency were available and could be used as a common intervention medium. This would be the most efficient way by which coherence, from the point of view of exchange rates might be maintained in a multi-currency area which, for a while, will need to combine a limited degree of internal flexibility with external floating.

Until recently the common intervention medium was the dollar. Whereas the dollar is gradually being phased out of intra-E.C. official transactions, disappointingly small progress has been made in finding an adequate substitute for it. The reasons for this are technical, economic and political.

From the technical viewpoint, it is important to note that the rise of the dollar to the position of an international currency was assisted by a formidable banking and financial infrastructure. If there is an E.C. currency which might offer comparable facilities, there are doubts as to the readiness of other E.C. countries to hold it on a large enough scale. In fact the E.C. currency which is now the most sought after as a reserve asset belongs to a country whose money and capital markets are surely inadequate to play a central role in the Community and whose authorities seem not keen to see such a role develop.

Economically, the substitution of the dollar by a national E.C. currency would not quite eliminate the conflicts which have arisen under the dollar standard, but rather transpose them into a European context. Though less sharply perhaps, conflicts would be bound to arise if a currency linked to a national economy was asked to fulfil the rôle of the European currency, as long as member country economies are not fully integrated. It would be unrealistic to assume that a national currency would be managed in such a way as to give priority to the Community's overall needs. If that could be done, it would also be appropriate to give the issuing central bank a European general management. The national currency would then be such only in name; in actual fact it would be a true Community currency. It is difficult to see how the country concerned would agree to this sort of arrangement, which would deprive it of autonomy in managing its own currency, an autonomy its partners would continue to enjoy, if only to a shrinking extent.

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Finally, political and prestige considerations make most member countries disinclined to second the rise of one of the existing national currencies to a position of primacy within the Community.

It would appear from the foregoing that for a currency to be suitable for the role of Community currency, one would have to create it ex nova.

2) Formulae for the Common European Currency

An important question which needs to be answered, when creating a Common European Currency, is how to relate it to the existing national currencies. There are of course a number of ways of doing this, as shown by way of illustration in what follows.

One possibility is that the Common European Currency comes into being as a result of the upgrading of the European Monetary Unit of Account (EMUA). In fact, the insertion of the word "monetary" seems to point to the likelihood of the EMUA being something more than an accounting notion. The EMUA, which basically repeats the formula of the unit of account used for the purposes of the C.A.P., is rather restrictive as regards both the cases of automatic changes and their scope. Being too static, and thereby open to the risk of losing contact with the national currencies, ample room has had to be left to the Council of Ministers' discretionary decisions. This, in turn, is likely to add so much uncertainty concerning the possibility of the EMUA changing, or not changing, that its widespread use especially in the private sector might be ruled out.

Furthermore, the EMUA is defined in terms of an asset, gold, concerning which the Community has a limited say, along with a number of other countries. Recent experience has shown that gold, its use and price, can altogether break away from the control of monetary authorities. Therefore, a consensus is now emerging in official circles about the unsuitability of gold as numéraire in the international monetary system. It is unfortunate that the EMUA should have been defined in terms of gold (1).

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(1) This, however, does not necessarily imply that gold cannot serve any useful purpose in the construction of the European Monetary Union. Because a large body of opinion still regards gold as a factor of monetary discipline, the issue of the Common European Currency might be linked to gold. The link should be fractional and adjustable in order to avoid building into the mechanism of creation of the European currency a constraint of the gold-standard type. As the C.E.C. circulation expanded, the link envisaged here would lead to the de facto centralisation of the national gold stocks.

This and other considerations militate in favour of defining the European monetary medium in terms of monetary assets, such as member countries' currencies, which are internal to the Community. The Common European Currency would be defined as a bag of currencies in which each currency would carry a weight according to a chosen parameter, such as the GNP, the foreign trade, or a combination of both. The formula might be so conceived as to have the Common European Currency reflect parity changes of a national currency, in proportion to its weight in the bag. Alternatively, the content of the bag might be defined in a way that the devaluation (revaluation) of a currency would necessarily lead, through arbitrage operations between the Common European Currency and the national currencies, in the absence of official action, to the upward (downward) adjustment of one or more other currencies. In the former case, the external value of the Common European currency would change automatically; in the latter it would not, since the change in one currency would be offset by a change of opposite sign in one or more (other) currencies (1).

The former formula implies that changes in the Common European Currency would equal the weighted average of changes in the national currencies: the Common European Currency would be as stable, or unstable, as that average. According to some, this is the sort of protection against exchange rate changes which is sought by the market. Therefore, a Common European Currency so defined would easily spread; it would be used for a Community-wide open market policy, as well as for issuing loans on the European financial market.

(I) In the former case the Common European Currency is defined as follows

$$I\ CEC = Q_{BF}BF + Q_S L + Q_{DM}DM + Q_{FF}FF + Q_L Lires + \dots$$

If the value of one of the national currencies changes, the value of the CEC changes pari passu with the weight of this currency in the bag.

In the latter case a constraint is added to the previous definition. Par values of the national currencies in terms of CEC's are fixed so that the following equality is always satisfied

$$I = Q_{BF}V_{bf} + Q_S V_S + Q_{DM}V_{dm} + Q_{FF}V_{ff} + Q_L V_I + \dots$$

where (i) V_{bf} is the par value in terms of CEC's of the Belgian franc and similarly for V_s, V_{dm} etc., and (ii) as a result $\frac{V_{bf}}{V_s}$ = the par rates of exchange between the pound sterling and the Belgian franc. If the Q's are fixed any change in one of the V's must be compensated by a change of at least one of the other V's in the opposite direction.

Concerning the latter formula, it is felt that forcing devaluations (revaluations) on some currencies as a result of the revaluations (devaluations) of other currencies might not be acceptable to monetary authorities. On the other hand, it should be borne in mind that because intra-EC flexibility of parities would have to be limited and would shrink over time, no large change might be inflicted on currencies, as a result of the combined application of this formula and of the flexibility schedule suggested in the previous Section. What this formula would lead to is the automatic sharing of the adjustment of parities between weak and strong currencies. This would be in keeping with the widely felt need for more symmetry in the process of adjustment.

Finally, it is worth pointing out that because the current inflationary outburst has undermined confidence in most currencies, a guarantee of stability in terms of currencies, and especially one which only afforded the average stability performance of member countries 'currencies, might not be adequate to make the Common European Currency as much competitive as needed vis-à-vis the strongest currencies, and non-currency assets as well.

There are various ways for securing for the C.E.C. a better-than-average performance. One would be to increase the weight in the bag of the currencies belonging to member countries with a low propensity to inflation. Thus, the weight of those currencies would exceed that posited by the application of the parameter chosen, and do so by the amount needed to make the Common European Currency as hard as necessary. At the limit, of course, the C.E.C.'s exchange rate changes would equal those of the strongest currency : the former currency and the latter would tend to assimilate each other. This, however, is unlikely to be accepted by member countries, on both technical and political grounds.

An alternative way of securing for the C.E.C. the stability apt to make it attractive would be to link it to a real, rather than monetary, parameter. In its extreme version, this formula would link in a 1 : 1 ratio the C.E.C. value and rises in (some) commodity-price index. In other words, the Common European Currency would appreciate in terms of member currencies as an E.E.C. average price index of goods rose.

It will be argued in what follows, however, that absolute stability of the C.E.C.'s purchasing power is neither feasible, nor desirable. Instead the aim

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might be a somewhat better-than-average performance in terms of currencies to be attained through the combined application of the bag-of-currencies and commodity-index formulae. More specifically, one would start from the weighted average of changes in member countries' currency parities, and then would revalue it by a fraction of any increase in the commodity-price index. The fraction relevant for each given period would be decided upon by the Council of Ministers. Thus, the formula for determining parity adjustments of the Common European Currency would be semi-automatic.

The foregoing discussion does not, of course, do justice to the many issues involved in the choice of one formula, rather than another. On the other hand, the fact should not be overlooked that the schedule of flexibility suggested in this report leaves little scope for changes in national currencies' exchange rates, and therefore restricts the potential for changes in the Common European Currency. What is essential is to move from the unit of account concept to the reality of a unit of transaction. A mere unit of account would be hard put to compete with the dollar (or an E.C. national currency). Failing positive steps from the official side, the process of spontaneous evolution of the EMUA into a currency proper would be drawn-out, uncertain and liable to setbacks. This would be hard to reconcile with the urgency which is now felt for Europe's monetary unification.

3) The Common European Currency as "monnaie cambiaire"

In order to serve as an intervention currency, the Common European Currency would not and could not be just an official asset. It would need to be held and traded by market-institutions, thus allowing it to be used as an intervention currency and, further, as a transaction currency. These different functions are closely interrelated. In what follows, they are included in the special notion of a "monnaie cambiaire".

The Community central monetary authorities (including the national central banks acting as a Community body) would chart the course of the Common European Currency so as to secure for the Community as a whole the sort of payments equilibrium with the rest of the world, consistent with the balance of payments aims agreed internationally by, and for, the Community as a whole. The European Fund for Monetary Cooperation would intervene on exchange

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markets in dollars and any other currency, if necessary, in order to control or influence the European Currency's exchange rate. In turn, the national central banks, acting individually, would buy and sell their own currency (solely) against sales or purchases of C.E.C.

In order to help the new European currency to come into its own, a large demand for it will need to be created : this, of course, depends on the uses for which it will be eligible.

A sizeable demand will be generated by the new currency fulfilling the rôle of intervention medium : participants in the exchange market, both offical and private, would need to hold working balances in the C.E.C. Transactions between the Community institutions and the national governments for the purposes of the Community's budget, of the common agricultural policy, etcetera, would of course take place in the Common European Currency. It would also be used for payments between Community institutions and private companies, and other bodies, in member countries.

Furthermore the Common European Currency ought to be used for issues and other transactions on the Community capital market. C.E.C. loans would be issued by large borrowers. To make such loans attractive to investors a clause of indexation (to the cost of living) might be attached to them (1) even when such clauses would not be allowed for issues in national currencies. The Community financial institutions would issue C.E.C. denominated loans, thereby creating a link between the mechanism of monetary unification and the process of economic growth in the Community. Also national governments and local authorities, desirous of tapping the Community's capital market might be permitted, as unification proceeds, to issue part of their debt in the Common European Currency. They might also be authorized to issue given amounts of (medium and) short-term notes in the Common European Currency for which the European Fund would offer rediscount facilities.

The banks participating in the C.E.C.-market would be required, as a regulatory device, to hold compulsory reserves in the Common European Currency, in an appropriate ratio to their C.E.C. - liabilities. Those banks would, of course, also be expected to organize a secondary market for C.E.C. denominated assets, as well as to cooperate with offical bodies in order to create adequate clearing facilities.

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(1) Any such clause would, of course, be superfluous if the C.E.C. formula already took into account losses in purchasing power by all currencies, as suggested earlier.

Finally, to promote the Common European Currency on its way towards being a transaction currency the governments might accept the new currency (in a fixed or rising ratio to their own national currency) for payments of taxes by at least some categories of taxpayers, such as affiliates of companies with the head office, or the main centre of operations, in another member country (or in a third country).

Thus, by replacing the dollar, and more specifically its euro-variant, and by taking over supplementary functions of a transaction currency, the Common European Currency would develop in the markets as a monnaie cambiaire. Participants in the C.E.C.-market would be the banks, particularly those which now engage in Euro-currency operations. They would deal in the Common European Currency with one another, with the central banks intervening in the markets for steering the exchange rate of their own currency, and with the European Fund for Monetary Cooperation. Also the participation in the C.E.C.-market of the large industrial and commercial companies, whose operations stretch beyond the national borders, might be envisaged at an early stage.

A different approach would ~~consist~~ in declaring the new European currency legal tender a least for some categories of transactions, defined on the basis of their (multi-national European) nature, or of their size. But this would meet with resistance from even those who believe in the need of introducing a European currency at an early stage. For it is felt that to promote that currency through coercion would detract from its intrinsic desirability. The procedure ought rather be to declare the new currency legal tender, alongside the existing national currencies, after it had proved its intrinsic desirability in a restricted group of professional large-size users and it had subsequently gained acceptability nearly all the way down to wage earners and retail shoppers. After all, in developed countries the bulk of payments is done by bank cheques whereas only central bank notes (and treasury coins) are legal tender.

4) The management of the Common European Currency

In this age of unrelentless inflation and monetary disorder, the Common European Currency would stand a good chance of becoming acceptable on its own merits, if it could be regarded as a relatively stable standard of value. A choice will have to be made, for at least as long as the Common European Currency will not be able itself to exert a decisive influence on economic

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trends in the Community, between absolute stability and the average instability of member countries' currencies. Choosing the former, however desirable in itself, would very likely put a heavy strain on the new currency. It would put it on a course not representative of member countries' currencies. It might hamper its diffusion in so far as debtors would be unwilling to express their debts in a too rigid standard of value. The interests of creditors, on the other hand, would go in the opposite direction. This conflict would hinder the smooth working of capital-markets in the Community.

The conflict would be more serious if a gap between the stability performance of the Common European Currency and a weak national currency formed, which would make the latter suspect for devaluation against the C.E.C. The demand for the Common European Currency might obtain a level which would make it possible to maintain the internal limited flexibility-schedule. All this would reduce the chances that the Common European Currency might eventually play an effective rôle in the evolution of new monetary arrangements in the Community. If, instead of adopting a formula for absolute stability for ever, it was aimed at a measure of stability clearly above the member currencies' average stability, as outlined in subsection 2, the effectiveness of the Common European Currency in fostering a better monetary performance all round would be much enhanced.

The stability performance of the European currency cannot be but the reflection largely of the combined performance of the national currencies, unless one were ready to break the proposed pattern of internal limited flexibility, and joint floating _erga extra_. In that case, however, an important element of strength of the European currency would be lost, for the strict delimitation and shrinking size of the exchange risk are likely to make the Common European Currency more desirable than competing external currencies, which may bear for Community residents a potentially unlimited exchange risk.

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The pattern here suggested, with regard to a more stable currency value and internal exchange rate flexibility, seems also the most suitable to secure the sort of evolution one would like to see in the relationship between the new European currency and the national currencies. During the transitional period a smooth process of unification should avoid sudden eruptions of currency speculation out of, and possibly back into, a Community currency, as well as massive shifts into the Common European Currency. Shifts into the latter would increase the amount of it which would be in circulation but ought to reduce *pro tanto* that of the national currency sold. Since such shifts would not reduce the overall liquidity of the economy concerned, the central bank issuing the currency exchanged for the Common European Currency would not be allowed to try to offset such shifts by means of further issues. Rather, it would have to increase the demand of its own currency for instance by raising interest rates on deposits, and other money and financial claims, in that currency.

The scheme here proposed would be likely to prevent both these inconveniences from happening, although countries would have to sacrifice to some degree their autonomy in interest rate policy, which is bound to happen in any case if progress is to be made towards unification. But under a revised adjustable peg system, large waves of speculation would form as parity "jumps" became more and more likely. In that case, it would be true that the existence of the Common European Currency alongside the national currencies (and their interconvertibility) would make a difference from the viewpoint of currency speculation, for it would be likely to give this latter a new field of operation.

Clearly however, the technical suitability of the exchange rate set-up is not a sufficient condition for avoiding inter-currency "flights" and the need for large support of the "suspected" currencies. Effective policy harmonization is needed, and this can only be attained if a consensus is reached concerning the unemployment-inflation trade-off at which the Community as a whole would aim. The chances that harmonization would be accepted, would of course increase if the Community collectively could make a positive contribution to improving that trade-off.

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As to free intra-group floating, which as it has been seen on several grounds is irreconciliable with the process of unification, it would also be unacceptable insofar as it would lead to the sudden dereliction of the fast depreciating currencies, and their substitution by the Common European Currency. The latter would have to be managed so as to keep in close touch with the fastest appreciating currencies, lest it be supplanted by them. An evolution of this type would hardly be acceptable, especially because it would mean that only some of the national currencies would prematurely disappear from the Community's monetary scene.

These, of course, are the very reasons why it is likely that the Common European Currency being in circulation side by side with the national currencies, would exert a powerful disciplinary influence. But discipline cannot work satisfactorily and it is bound to be "contested", if it is achieved through the threat of drastic changes in the pre-existing mix of Community and national elements.

In principle, it seems safe to assume that the more gradually the use of the Common European Currency will spread, the more acceptable the process of ultimate replacement of the national currencies will be.

The speed at which the Common European Currency may be allowed to spread needs also to be controlled because its unregulated use by the private sector would lead, as in the case of the Eurodollar, to an excess creation of liquidity. Since the need for European monetary unification has been more strongly felt in order to regain from U.S. banks and Euro-banks control over domestic monetary conditions, it follows that the process of creation of the Common European Currency must be firmly in the hands of Europe's monetary authorities.

Those authorities would concur in defining and implementing a harmonized European monetary policy especially with regard to money supply, which however would not imply that rates of increase would be equated for all member countries. One might start by agreeing, in special circumstances, on a Community band within which rates of increase in national money supply would have to be kept. In implementing such a European monetary policy the creation of the Common European Currency

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and national money creation by the central banks of member countries would have to be so regulated as to meet the liquidity needs of the Community as a whole, as well as of its large economic regions, without adding to inflationary pressures. Clearly it would not help the C.E.C. to come into its own, if it could be construed as one more engine of inflation. One of the conditions necessary to prevent this is to time and regulate the process of creation of the C.E.C. so that the latter might grow in importance pari passu with the merging of the national central banking systems into a Community one.

As to the control of C.E.C. creation by the private sector, regulations might be of a quantitative and/or qualitative nature. Without going into too much detail about the different instruments to be applied, it should be stressed that compulsory reserves would be required against C.E.C. liabilities. These would be higher or lower than reserve ratios on liabilities in national currencies, as might be needed in each specific situation. Also the use of the Common European Currency might be restricted to specified categories of (intra-European) transactions.

The rate at which the Common European Currency would spread (to larger categories of users) might also be regulated by allowing its use only for deals exceeding a given (minimum) amount. In fact, the Common European Currency might first be introduced in the private sector under the form of large-denomination C.E.C. certificates, in which banks and treasurers of big European companies would deal. Just as within countries some forms of money are legal tender only for payments up to a given amount, so the Common European Currency would be usable for transactions above a minimum amount.

Administrative controls, which would restrict the interconvertibility of the Common European Currency and the national currencies, should instead be kept at a minimum - and even that should be quickly discarded. Controls, exchange or other, which discriminate according to the residence of borrower or lender, or according to the location of the investment, hamper the process of integration of the economies during the transitional period, just when that process ought to be progressing. And they do so much more than slowly-moving currency prices especially if these make possible the maintenance of unrestricted convertibility.

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Unrestricted convertibility of the ~~Common~~ European Currency should be aimed at, if it is to play the role of a common currency, and if it is to integrate in depth national money and capital markets, reaching intra-marginal lenders and borrowers. Those markets have worked so far as communicating markets rather than fully integrated ones. They are at present threatened with the closure of the points of communication as a result of the deteriorating usability of the dollar.

It is an essential feature of the proposals made in this report that there should be little use, if any, for intra-E.C. administrative controls in coping with payments disequilibria. In fact, as with monetary union, old-style balance-of-payments problems will be superseded by regional development problems as codetermined by regional disequilibria in the availability of financial resources, the aim should be an allocation of those resources, both short and long term, consistent with the indications of a European policy of balanced growth. That aim cannot be achieved in markets which are moving towards integration, by means of national administrative controls which discriminate as between E.C. residents. A Community monetary and financial system is needed, which ought to be able to correct the possible inconsistencies in respect of an "optimal" policy of growth for the Community as a whole, that might arise in the allocation of funds, within a context of full freedom of circulation through the national markets.

The proposed Common European Currency might be built as an essential part of that system. As such, its usefulness would continue also once conditions were ripe for definitely locking together intra-European exchange rates and thus merging national currencies.

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ECONOMIC AND SOCIAL POLICIES FOR MONETARY UNIFICATION AND ECONOMIC INTEGRATION

In considering the economic aspects of economic and monetary union, two approaches are possible. The first is a narrow interpretation of the parallelism discussed at the beginning of this report, so that only those non-monetary policies are proposed which must accompany monetary unification. But the potential gain, in growth and stability of member-state real national products, and in the development of Community identity and solidarity, from further co-ordinated economic and social policies, is very great indeed. Thus, over and above the minimal rate of economic integration as monetary unification progresses, vast scope is offered by many further economic and social policies.

The minimal rate of advance consists in the development of those common policies which are inescapable if intra-Community exchange rates are moving towards being locked. Some policies are clearly in this category as we have seen, e.g. means of dealing with resultant short-run and structural imbalance in regions and industries. Other policies, though highly desirable in themselves are not, e.g. environmental policies. The line is not always easy to draw. It should certainly be drawn on the liberal side, because advance in economic union has its own significance; and parallelism must not be seen only as an in-filling of crevices wrought by monetary union; it has a great positive role to play, probably more than developments in the monetary field.

A. STABILISATION POLICY

1) Three levels of Stabilisation Policy

There are various levels at which the attempt to achieve a steady rate of growth of G.N.P. with price stability and full employment under a balance of payment constraint has to be made : the Community cycle as a whole, member-state divergencies from that cycle, and regional divergencies from member-state norms.

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The manifestation of the problem varies in each case, sometimes inflation rates, sometimes unemployment rates, sometimes outdated infrastructure or deficient public services. The cause of the problem varies similarly, from short-term demand deficiency to long-run decline of industries due to secular falls in world demand or inefficiency arising from cost increases outstripping productivity improvements.

It is customary accordingly to divide conjunctural from structural policy. This is legitimate, and is largely followed in this part of the report, insofar as the analysis of the problem is concerned. But it may not be valid from the point of view of the instruments of policy. If different instruments can be assigned to conjunctural and structural policy, the distinction can be maintained, but it becomes confusing if instruments, e.g. fiscal policy, need to be considered in a consolidated way in dealing with both types of problem, conjunctural and structural. Since there is need, especially from the fiscal point of view, for a comprehensive approach, this is why the three levels of stabilisation policy are dealt with in this section, even though regional policy is examined further in the next section.

The changing balance of importance of the three levels of conjunctural policy is a matter of debate. The question whether the Community cycle is becoming more firmly established, and member-state divergencies less significant, has already been discussed. However far this has developed at present, no doubt EMU will accentuate this transmission of inflation and depression between member-states. On the other hand, regional divergencies (from Community or member-state norms) may be accentuated by EMU, as it is developing now, as has been mentioned earlier in the report.

Of course, this development of the conjunctural problem upward and downward, away from the level of the member-state economy, conceals a difference in type of the problem : the Community cyclical problem is short-term and is dominated by prices, the regional imbalance is longer-term and dominated by

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employment, and the distinction between conjunctural and structural is valid. There is also a difference as to instruments appropriate and available. Monetary instruments, including parity changes (vis-à-vis outside countries), money supply and interest rate policy, remain available to the Community as E M U progresses. These are the right instruments for the right problem - influencing the Community cycle.

Thus, monetary unification does provide the instruments to the Community which are necessary to deal with the development it brings about: the consolidation of a common cycle among member-states. Their use has already been covered adequately in the preceding monetary discussion.

2) Fiscal Instruments for Intra- Community Stabilisation Policy

What has not been discussed so much are the major problems of member-state stabilisation, and dealing with the possibly accentuated problem of regional disparities. Though limited availability of monetary instruments will remain during the transitional period, the emphasis must shift to budgetary instruments to deal with these aspects of stabilisation policy, and this is why these two aspects of policy need to be looked at together.

Short and medium-term changes on the expenditure side (of Community or member-state) budgets are of limited significance, as always, in view of formal commitments to programmes.

In the case of the Community budget, some flexibility may be available if a form of Community employment benefit scheme is founded, but most other elements of the budget, will not be easily adjustable for stabilisation purposes. Member-state budgets are going to be difficult to control. There is, at present, reporting of budget deficit positions by member-states three times a year, some supervision of these and of their financing must be allowed to develop. But the weight is on the fiscal side, and unfortunately this runs counter to some plans for the harmonisation (meaning alignment of structures and rates) of taxes,

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argued on the grounds of removing distortions to trade and factor movements. In particular, the very tax most subject to alignment pressures, the V.A.T. is in the very category of general sales taxes commonly used for short-run stabilisation purposes.

Earnest consideration has to be given to this problem. Even if the removal of tax distortions to trade and production by uniformisation of taxation increases total real income, the gain is much reduced if this worsens the distribution of wealth around the Community, and neutralises the tools to correct the imbalance.

In the medium term, therefore, the Community would obtain comparatively strong monetary instruments, as part of monetary unification, whilst its direct budgetary instruments will remain small; for the member-states, conducting (with a degree of Community supervision) national and regional stabilisation policy, monetary instruments will be weak, but as compensation, fiscal flexibility, including V.A.T. rates, should be allowed to develop. As the extreme and economically more relevant version of this proposal one could envisage the institution of regional differentials (where the divergence from Community norms of income and employment may be greatest) in V.A.T. or other taxes.

3) Prices and Incomes Policy for intra-Community Stabilisation Policy

Within several member-states, use of the law and consultation to control prices and money incomes has become as important as fiscal policy.

Co-ordination of national incomes policies in a Community programme is a medium-term aim*, but poses problems which have hardly begun to be tackled. At the very least the introduction of a permanent and efficient dialogue between the public authorities and the social partners (unions and firms) at the European level is necessary. In order to be comprehensive enough it should incorporate the global and structural policy of public authorities and boil down to coherent decisions on the development of average wage- and price increases.

* Cf. the chapter "Incomes policy" in the Second Medium Term Economic Policy Programme and the paragraphs 102 and 133 concerning the "Dialogue with the Social partners" of the Third Medium Term Economic Policy Programme, adopted by the Council respectively in 1969 and 1971 (Official Journal L 129 of 30 May 1969 and L 49 of 1 March 1971).

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The basic issue lies between the economic requirement of different real income levels (in a given sector) in different parts of the Community to accord with differences in productivity levels, and the social objective of greater equalisation of standards of living in all regions. Joint incomes policies agreed with, possibly Europeanised, trade unions, are likely to tend towards the social objective, and hence worsen the disequilibria between regions of unequal productivity. The social objective may naturally take precedence, and the economic requirement be met rather by tax and social security adjustments for the weaker regions.

This brief discussion emphasises the need for simultaneous and coordinated action to achieve balanced growth, with minimised inflation and relatively full employment, in all parts of the Community - action in the fields of taxation, public expenditure, social security and prices and incomes policies.

B. REGIONAL AND EMPLOYMENT POLICY

The Commission has recently issued a report and has submitted several proposals to the Council in the field of regional policy*. The Community's effort itself is to be implemented through a Regional Development Fund** whilst a Regional Development Committee will make surveys of and begin to harmonise Member States' regional policies. Assistance from the Fund will be decided on a case-by-case basis for larger schemes*** and in the aggregate for smaller ones. The Commission has proposed including a sum of 500 mn U.A. in the Community budget for 1974. Sums in the area of 750 mn U.A. for 1975 and 1,000 mn U.A. for 1976 will be required. As regards the mode of allocation this will depend on the expansion of production rather than use for welfare payments.

I) Meaning and Definition of the Regional Problem

The regional problem itself is ambiguous and fluid. Indeed, some economists would want either to abandon the concept, subsuming the problems under labour market and industrial policy; other would re-cast it as location policy, with the income distribution content removed to other policies.

* Reference to COM(73)550 final, 3 May 73 - COM(73)1170 final 25 July 1973 - COM(73)1171 final, 25 July 73 - COM(73)1218 final, 25 July 73 - COM(73)1751, 10 October 73.

**An Employment Fund is also being established and will have a connection with regional policy.

***Industrial and service investments of an amount of 10 mn U.A. or more, and infrastructure investments of an amount of 20 mn U.A. or more.

Since criteria for the distribution of regional funds depend on the determination of a region in need of aid, criteria likewise are difficult to pin down. The actual situation which policy has to influence is already fast-changing, and is likely to be increasingly so. Analytically, the regional problem is caused by the disparity in trends of factor and productivity rates, so that "highly" paid labour can no longer be employed by areas or industries with lagging productivity levels. The problem posed by E M U is that it is likely to lead to a faster convergence of factor price levels (on the capital side, by capital market integration; on the labour side, by Community wage-bargaining and wage-emulation) than it is of productivity trends. It is uncertain whether or not productivity levels will converge: geographical polarisation theories are opposed by systems lessening dependence on proximity to markets, new products lessening dependence on natural resources, etc.

But this is still to see the "regional problem" in traditional terms. We might be on the threshold of a new concept of the "regional problem" (indeed envisaged in the Commission's latest report) characterised by congestion and infra-structure run-down and decay. And this progress might also be accelerated by the industrial and social changes of E M U .

Furthermore it should be recognized that the problem of regional and structural imbalances has its particular political and social impact. The member states of the European Community have a much more intensive national life than the members of the existing federal states, e.g. the United States or Australia have. They are countries which feel their national identity strongly and are less able to tolerate economic disparities between one another then they are within the nation states.

Thus, it is going to be exceedingly difficult to <u>define</u> the regional problem in future years. And this presents another issue: as the regional problem become more heterodox, each member-state (or region) can make a claim for itself.

In these circumstances, a list of Community criteria is going to be difficult to define. Probably, they should be very few and very simple, perhaps put only in terms of income and unemployment levels.* Once multiple criteria

*The commission has proposed using the deficit in the migration of labour force as an additional criteria. Cf. COM(73)1751, 10 October 1973.

are let in, the situation could become unmanageable. The situation to be avoided is the possibility of states and regions able to propose schemes and criteria which net out to their own benefit; Community regional and employment policy would then tend to become ineffective and confusing.

2) Community Regional Policy and Member-State Regional Policy.

It has been stated, in connection with the Commission's report that its [illegible] the Regional Fund [illegible] partly replace [illegible] spending.

This seems an undesirable situation, to be avoided if at all possible. The reasons are two-fold. Firstly, whilst the Regional Committee is to co-ordinate member-state regional aid, it will have much more difficulty in applying uniform criteria, than in the case of direct Community aid. Secondly, it is difficult to see how substantial finance can become available for the Regional Fund without a transfer of ressources from member-state budgets. This does not include use of loan finance through the European Investment Bank or other means. If possible this should not exclude the possibility to add to the amounts envisaged by supplementary measures. This will be taken up again in discussing the Community budget.

3) Mode of Community Regional Policy

Earlier, it was suggested that sharp, simple criteria should determine a region qualifying for aid. This appears to be in some conflict with the forceful idea that each region in need will have a particular identity and special problems, so that an assortment of aid methods might have maximum effectiveness. However, there need not be conflict; there is a two-stage process. A qualifying region is determined on income and employment grounds. When qualified, its "programme support" is decided in the field according to its special needs, and consists of a special set of grants/loans to new/existing industries, retraining grants/income support for all/selected workpeople, and finance for particular public goods and services.

So far, the mode of operation of the Community Regional Fund has pre-supposed its impact to be on the expenditure side, with finance raised by some unspecified means. But, of course, those means themselves can be an instrument of regional policy. The simplest method would be a tax with regional differentials, such as the V.A.T., or regionally differentiated payroll tax, or corporation tax. All sorts of problems are raised by such a suggestion. In the case of the V.A.T., it requires origin principle taxation and re-introduces fiscal frontiers, this time between regions. To use the corporation tax involves great difficulties over determination of where corporate profits arise, and of control. Nevertheless, the method of regionally-differentiated taxation, helps deal with the regional problem whilst also providing finance for additional action on the expenditure side.

C. SOCIAL POLICY*

1) The Social Fund Approach

The original conception of the Social Fund was to deal with unemployment resulting from the reorganisation of the customs union. The problem was conceived as a minor one - most reallocation would take place by autonomous changes by workers of location or job. Consequently, the size and scope of the Social Fund has always been very small.

It must become more important in the future. On the one hand, the Community must be expected to play a role in unemployment benefit schemes that it did not play before, and on the other, the unemployment problem might become more extensive. The problem of enemployment and redeployment was already a major concern when the customs union was launched; with the advent of E M U , the labour consequences of the resultant industrial re-organisation might well attain a new scale.

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* Note that "social union" was included as an element in the second stage of economic and monetary union in the Paris Summit communique - Reference to "Guidelines for a Social Action Programme" COM (73) 520, April 1973 also.

In dealing with this problem alone questions arise as to the required size of an enlarged Social Fund and its mode of use. It is estimated that the current annual rate of redundancy in the Nine is 3,750,000. If the outlays per head of redundant worker of the ECSC of 2,000 U.A. were applied in the Community, the implied size of the Social Fund would be impossibly large. It can be reduced by aiding only some of those made redundant, and by restricting the range of assistance given. It is generally agreed that the Community should concentrate on support for retraining, so as to give its programme a positive look. Even so, a Social Fund, envisaged but yet to be achieved, of 358 mn U.A. for 1973 (1974 : 471 mn U.A.), looks very small against ECSC standards. Greater enlargement than this appears a minimum accompaniment of E.M.U., unless the burden of labour adjustment is going to be taken on regional and industrial policies.

Whether the Social Fund is expanded to give the Community a fuller role in employment policy, or because the employment consequences of E M U are likely to require it, clearly there is no justification for its finance by a system of juste retour; those areas with the highest incidence of consequential restructuring need to receive most, pay least, the main contributors being those areas on the fortunate end of the benefits of E M U.

2) Alignment of Social Security Systems

Another great aspect of social policy lies in the possible alignment of the social security systems of the member-states. This does not necessarily have direct consequences for the Community budget, but has major implications for member-state budgets.

Whether alignment is desirable or not can be dealt with from an economic or social viewpoint. From the economic side, it is necessary to look at social security contributions by employers and by employees separately. The payment by employers is sometimes argued to be a quasi-wage. The question arises : do differences in net payments by employers and net receipts by employees in member-states interfere with the mobility and location of capital and enterprise on the one hand, and labour on the other ? The answer is probably Yes for capital, but is much more dubious for labour, as such a complex of socio-economic factors affects labour movement. The establishment of a Common Market with unimpeded factor flows therefore demands long-run alignment of employers payments to social

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security. And since the slice of social security that is financed through the budget of the member-state is variable and modifies the amount directly paid by firms, it is difficult to see how differences in the division of social security finance between state and the private sector can remain, except in a sense to be mentioned later. Whilst economic arguments support the alignment of member-state budgetary participation in social security, and of employers contributions, it is rather social forces which will, in the long run, demand alignment of benefits (and hence of the final residual items in the social security accounts of employee contributions). As social and cultural integration proceeds, there will be increasing emulation effects ; people with an inferior social service will view the best standard of provision in the Community with envy. Each state, as now, will be a shining example in one aspect - unemployment benefits, family allowances, pensions etc. - and form a goal for others. This "levelling-up" process is part of social innovation to be discussed later; it must be good and desirable, only the cost is daunting.

The sums involved are staggering. For example, the total cost of unemployment payments throughout the Community if provided at a uniform standard would vary from 960 mn U.A. at the lowest (Italian) standard, through 2,880 mn U.A. at an intermediate level (U.K.) to 9,480 mn U.A. at the best level (Germany). Similar results are obtained from "levelling-up" other social services.

Of course, alignment and theestablishment of Community standards of provision may or may not involve direct administration by the Community - member-states could be left to finance and administer the uniformised schemes. The key difference is that operation by the Community would tend to involve a redistributive element (assuming that the Community budget were not deliberately financed to ensure juste retour), with those with currently poorer standards of provision being the gainers.

It remains disputable, of course, whether all parts of the social security system should be subject to the alignment process, even in the very long run, when some aspects are very culturally identified with particular member-states - should not member-states always be able to provide more health, more education, if willing to self-finance it? It is true that this is in conflict

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with social integration in the Community, but it has often been asserted that the ultimate size of a nation's "welfare" budget (financed by non-harmonised taxes) would remain discretionary.

Whilst some parts of what is normally regarded as social security has little relevance to E M U , an issue which is not much discussed in European social policy, namely housing policy, is highly relevant both to efficiency (of the labour market) and equity. Attention should be given to the harmonisation of some aspects of member-state housing policy.

3) Social Innovation

This is the widest, and in many ways, the most fascinating view, of what Community social policy should aim to do. It includes what might strictly be termed "social", and what is rather "environmental":

Social - "in-work" policies, e.g. providing training and creating jobs for minority and disadvantaged groups such as youth, women, immigrants, coloured people; improving and changing conditions of work particularly in the factory; fostering effective worker participation; etc.

Environmental *- "outside-of-work" policies, e.g. adult education; leisure and cultural facilities; community centres; urban and rural protection; etc.

A strong case exists for such an interpretation of the goals of Community social policy. It associates the Community with the best of modern democratic thinking, and has its impact among those where the Community at present inspires adverse or zero feeling. It could disassociate the Community from "old" policies, such as some forms of regional policy, which have not been conspicuously successful when practised by member-states.

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* There are obvious connections with regional policy, but these policies are within the scope of the social policy document of the Commission referred to.

Unfortunately, as the appeal of these policies magnify, so does the cost. It is difficult to see how these could be financed directly by the Community, though perhaps the Community could urge implementation of some of them by member states, though the specific Community initiatives might not then be so clear to the people. If the Community were to implement some of them, it would probalby have to be at the expense of more orthodox spending policies. It really is a crucial question: whether the Community is going to duplicate member-state policies, or strike new ground in the socio-economic field.

D. INDUSTRIAL POLICY

1) Minimal Community Programme

There is a well-recognized list of policy heads comprising Community aims in industrial policy. These are (i) removing technical barriers to trade (ii) open tendering for public contracts and the development of Community procurement processes by Community public bodies in certain sectors (iii) writing of a European company code and harmonisation of national company law (iv) promotion of mergers and other Community assistance to small and medium-sized firms and projects (v) special aid to sectors on account of the need for reconstruction, high R & D costs, need for vast capital investment, etc. (vi) development of Community anti-trust policy and its co-ordination with member-state monopoly policies.

From this rather immense and costly programme the problem is to select those policies which are the most essential accompaniments of E M U , or which are fairly easy in terms of cost.

Work on removing technical barriers to trade, which includes harmonising standards, patents, weights and measures, etc. involves little financial cost, and certainly should be at an advanced stage if trade is being carried on in terms of a single European currency.

Open public procurement, involving goods, services and finance, fall partly under market integration, which economic union encompasses. Its achievement is mainly a matter of overcoming national protection, and should get ahead in the 70s, through the establishment of Community public corporation seems farther off.

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2) Longer-run Programmes

The next three elements of industrial policy all involve actual industrial re-structuring, usually into a larger, transnational scale.

It is difficult to distinguish that which is a necessary accompaniment to E.M.U., since, more than in the case of the removal of tariffs (which gave a lead on those industries to be most affected), it is very hard to forsee which industries will be most affected by the progress of E M U.

In general, it will be those with a strong geographical bias in certain parts of the Community, but assistance to these is a matter of regional policy.

It does seem that, at least in the second stage, industrial policy will have to be confined to the non-budgetary measures discussed above, plus that part of regional policy which has the aim of modernisation of industry.

For a long time, there may be a pressure for industrial policy, in its budgetary aspect, to be one of assisting lame-ducks, rather than having the more positive role of financing large semi-public projects of European interest, a pressure to be strongly resisted. Of course, in the main, trans-Community projects will develop anyway as private ventures, and some might argue that vast public funds should never be so used. When they are, such a project might have special provision, rather than depend on inclusion in the Community budget.

E. THE COMMUNITY BUDGET

1) Consultative and Regulatory Policies versus Budgetary Policies

A number of the policies discussed do not involve budgetary finance, but consultative procedures, and the establishment of Community law and regulation. These policies include, for example, consultation about, and co-ordination of, member-state budget deficits, regional aid efforts, company law, stock exchange regulations, competition policy. In the main, they do not involve conflict with each other, or face financing obstacles, and hence should be pushed ahead with, in a compartmentalised way, as fast as possible.

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Many other policies, and often the most crucial, need financial resources, a great obstacle to their development, and are in conflict one with another, for that very reason.

A very good way of confronting the limitation of financial resources and the decisions required between the policies discussed is to consider the development of the Community budget in the second stage (to 1976) and in the stage beyond (say, to 1980).

2) Projection of Community Budget Expenditure 1976 and 1980

The commencement point is a budget in 1973 of 0.57 % of Community G.N.P. (4,400 mn U.A.) *

Expenditures 1976 and 1980

(at 1973 prices)

	1976		1980-low		1980-high	
	U.A. mn	C.G.N.P. %	U.A. mn	C.G.N.P. %	U.A. mn	C.G.N.P. %
C.A.P. etc.	5,262	0.6	6,156	0.6	6,156	0.6
Social Fund) Regional Fund) Employment Fund)	3,508	0.4	14,364*	1.4*	24,624*	2.4
Total	8,770	1.0	20,520	2.0	30,780	3.0

* Industrial Policy included

We base our projection to 1976 (the second year of resources propres for the Six) ** on the Commission's recent estimate *** of the total size of the budget of 1.0 % Community G.N.P. (which target has not as yet been agreed by member-states) and by assuming a growth in C.A.P. a little above proportional-to-G.N.P. growth (C.A.P. expenditure represents 0.46 % C.G.N.P. in 1973).

* Figure revised recently to 5,420 mn U.A. - An increase to 6,080 mn U.A. has been proposed for 1974

** In general the acceding countries will fully participate in the system from January 1st 1978.

*** References to Commission's communication to Council on E M U, April 1973.

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In considering the balance between the non-C.A.P. expenditures, the Commission document declares that regional and employment policies must take priority in the second stage.

The two problems which present themselves are these (i) the small scale of resources available for non-agricultural policies (ii) the method of working toward largely similar purposes through three administratively separate funds.

When we come to 1980, we might postulate that the Community Budget will have continued to grow at the same rate as during 1973-76, or at an increased rate as transitional problems of enlargement are over and Community identity is more established.

Simple alternatives for 1980 are presented in the foregoing table by budgets totalling 2.0% Community G.N.P. (the low alternative), and 3.0% Community G.N.P. (high). There is nothing to go on at present as to the likely or desired division of the "balance" (after C.A.P.) over the various policies listed.

This is a rather unsatisfactory way, using mere projection, of establishing targets for the size of budget in the future. More satisfactory would be the approach of "costing" the various goals in regional, social and industrial policy. But here the problem is that the cost of these many intentions and hopes would yield a very much greater figure, which will appear unrealistic when the financing side is considered. This crucial problem of the "gap" between policy aims in the many fields, and the apparent budgetary limitations, is one which we draw special attention to in our conclusions.

3) Financing the Community Budget

Required finance for the above budgets is fairly easy to estimate in the broad. Revenue from the two agreed sources of C.E.T. and agricultural levies sum to 0.52 % Community G.N.P. in 1973 (net, i.e. 90 % of member-state actual receipts). It is not possible to forecast the trend of this % in view of structural changes to be expected during 1973 - 80, e.g. changes in world food prices, in the C.A.P. itself, completion of new trade pacts with third party countries, etc. In general, it might be assumed that these two sources of finance will not be very dynamic, and so

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they will only grow in proportions to C.G.N.P. Then, they will provide for (say) a budget of o.5 % C.G.N.P. throughout the period. Consequently, the "extra" finance which has to be found for our 1976 and 1980 budgets is as follows:

1976 an extra 0.5 % C.G.N.P.
1980(low) an extra 1.5 % C.G.N.P.
1980(high) an extra 2.5 % C.G.N.P.

This "extra" finance can be raised from one (or more) of several sources:

(i) V.A.T.
(ii) Corporation tax
(iii) Seignorage on a European currency issue
(iv) Short - and medium-term borrowing
(v) Direct contribution by member-states

The requirements in terms of V.A.T. are easily calculated in broad terms. It is almost true that, with harmonised taxes along the lines of Community Directives and Commission plans, a 1.0 % V.A.T. rate in the Community at large yields o.5 % of the Community G.N.P. From this factor, the Community V.A.T. rate required to entirely finance the "extra" margin in all our budgets is simply deduced: *

	V.A.T. required, in addition to C.E.T. and Levies
1976	1.0 % V.A.T.
1980 (low)	3.0 % V.A.T.
1980 (high)	5.0 % V.A.T.

If we consider finance by the corporation tax, a useful factor is that corporation tax yield in the Community is approximately equal to a 3.25 % V.A.T. Its potential as a source of finance can immediately be seen by reference

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* A uniform Community V.A.T. rate system, for financing purposes, can be combined with a flexible member-state rate, for stabilisation purposes, as proposed earlier.

to the V.A.T. requirements to finance our Community budgets - it would completely finance the "extra" required for the 1980 (low) budget. Of course, it is very dubious that the whole of current corporation tax proceeds could be utilised in this way. Modified proposals consist in the payment of a Company corporation tax by companies incorporated under the new Community company code. Its yield, by 1980, would of course only be some proportion of the above, dependent on the progress of the development of Community company law.

Turning to non-fiscal means of financing the Community budget, both methods mentioned involve the progress of monetary union and the development of the European currency.

The annual revenue that could be expected from seignorage (or right-of-issue) can be calculated as follows.* If the European currency became 10 % of the European money supply, and inflation and the real rate of growth are each assumed to be at 5.0 % per annum, there is a revenue yield to the Community budget of 0.4 % of C.G.N.P. annually, as a result of the growth of Community money income. This could cover approximately one-sixth of the 1980 balances.

However, the use of this means of financing the budget is a much disputed one. Historically, the method has always been used in part and in greatly varying degree in the finance of budget expenditures by European nation-states. But the transfer of such powers to the Community would, now, give rise to acute political controversy.

In addition, from the economic viewpoint, the method may be inflationary (depending on numerous conditions such as the degree of replacement of seignorage earnings to American citizens through the operation of the Euro-dollar market) and insofar as it was so, the method would be in conflict with the anti-inflation policies which the Community is currently much concerned with.

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* If M is the total Community money supply and V (assumed value 2.5) is the ratio of total Community income to M, then M V = Community Income

$\Delta M(V) = (0{,}05 + 0{,}05)$ Community Income

With a fraction of 10 % of the C.E.C. in the European money supply the revenue potential of the C.E.C. as a fraction of Community income is 0,1 =

$$\frac{0{,}1 \quad \Delta M}{\text{Community Income}} = \frac{0{,}1\ (0{,}05 + 0{,}05)}{2{,}5} = 0{,}004$$

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The method of financing a Community budget tax-revenue deficit by short- or medium-term loans, does not essentially depend on the existence of C.E.C.(since issues could be floated by agreement with member-states in national currencies) but rather obviously ties in as a joint development in monetary union. The term-structure of such loans gives rise to complex economic and monetary effects, and requires co-ordination with member-state debt policies.

The final method of finance that is listed, direct contributions, is a return to the old system, undesirable since it involves a diminution in Community identity, and should only be regarded as a last resort if all other means fail.

4) The Community Budget and the Progress of Economic Integration

The overall conclusion is that a very large gap exists between the more extensive goals of regional, social and industrial policy, and what appears to be feasible in terms of a Community budget even at the more optimistic level of 1980. It is doubtful if even the minimal programme of regional/employment/social policies, needed to meet the dislocation produced by monetary and capital market integration, can be met.

The member-states should be asked to recognise more fully the need to make available financial resources to meet the economic and social consequences of developments in the monetary and capital fields. Since the latter is bringing real income gains, this only represents some transfer of the gains of E.M.U. to the public sector. Alternatively, if it is politically impossible for member-states to raise extra tax revenues for Community purposes, the imperative need for a growing Community budget must be met by a transfer of some current member-state budgetary resources.

Even with such transfer, the Community budget will continue to look small, when its command of resources of 3.0 % C.G.N.P. is compared with member-state budgets of 20.0 - 30.0 per cent of their G.N.P., and when compared with federal finance systems in U.S.A., Canada, Australia, etc.

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Some would argue that it is not only small, but distorted, in the sense of representing policies on both the revenue and expenditure sides, which are crying out for revision. On the expenditure side, the obvious candidate for re-examination is the mode of agriculture spending*. On the revenue side, some would wish to see a decline in the revenue sources of agricultural levies and common external tariff, in the interests of extending the free trade concept to areas of the world outside the Community, and, in particular, increasing non-reciprocal concessions to imports from developing countries.

Thus, in the longer-run, the Community budget should not only gain substantially in size, but change significantly from its present structure.

The longer-term must see the exercise of Community policies in the three classic budgetary policies of the provision of public goods, stabilisation policy, and distribution policy, directly and explicitly. This will require a Community tax system, Community expenditures of a short and longer-term nature, and Community debt management, also short and long-term. It is also incumbent on the Community to recognise that <u>all</u> of these fiscal and debt policies have an impact on <u>each</u> of the budgetary functions, and particular policies must be examined for their detrimental effect on some groups as well as for the benefits to others.

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* A review of C.A.P. is to be made by the Commission by the end of 1973.

IV. Concluding remarks

1. The development of the Common Market, characterized by the free movements of goods, services and factors of production, into a fully fledged Economic and Monetary union marks an important and perhaps decisive turning point in the building of the European Community. But there should be no delusion : the tasks and objectives still awaiting their fullfilment are by no means easier than the already difficult achievements of the past. The transition from the Common Market approach - which for sure has not yet come to an end - to the creation of an economic and monetary union, implies a shift of emphasis from market integration, to an institutional integration. The former is mainly concerned with the abolition of barriers to intra-EC trade and factor movements and the implementation of related common policies, particularly vis-à-vis the outside world, bound by common political responsibility, for effcient decision taking processes to work toward the common objectives and policies which form the core of EMU.

A new concept of parellelism, enlarging the accepted principle of parallel progress between economic integration and monetary unification, follows from this development. Whereas up to the present most efforts have concentrated on the integration and smooth working of markets, with EMU time has come to match a further deepening of market integration by action on the instrumental side through broad-ranging interdependend measures in the fields of economic and social policies. Further reliance primarily on liberalisation measures and markets would ultimately lead to a vacuum where national governments have given up the independent use of policy instruments to further social and economic goals without substituting them by common instruments and policies.

Against this background it has become questionable whether the old idea, dear to the founding fathers of European Integration of using economic integration as a lever to pave the way for the ultimate goal of political integration still offers a valid and reliable operational base for further progress of the movements towards a united Europe. The institutional integration necessary for a succesful economic and monetary union appears to make it hardly meaningful to push ahead only in those areas where consensus can be reached and progress is still possible. In this respect the development

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of the Common Agricultural Policy appears as a revealing example. Therefore, this approach no longer looks convincing now that the stage of institutional integration, implied in the transition towards EMU, is reached.

This report has not dealt with the aforementioned problem explicitly. It is founded on the widely spread politial will to achieve progress towards economic integration and monetary unification.

The point to be stressed is that the building of the Economic and Monetary Union will only succeed if simultaneous progress can be achieved over the whole range of issues that have been discussed in the preceeding parts, i.e. the comprehensiveness of the policy suggestions which have been put forward is more important than any of the individual measures proposed. Only such an approach will make it possible to deal adequatly with the conflicts and trade-offs implied in progress of the European construction.

It should be recongnized - more than has been the case up till now - that every Community policy has its impact on multiple objectives : monetary, economic, social and even political. In order to avoid that progress in one field is followed by even bigger steps backward in other fields, the costs and benefits of every policy should be evaluated and balanced. It is in this respect that the need for parallel progress in the different fields of the European enterprise gets its fullest significance. At the same time it should be pointed out that as far as the need for harmonisation policy is concerned what matters in the first place is not necessarily a greater uniformity of instruments but a better coherence of the effects of different policy measures.

2. As a viable and credible exchange rate system for the transitional period towards EMU, the report supports the dissociation of intra-EC exchange rate relationships from those with the rest of the world. At the same time it is recognized that for the time being, fixed intra-EC exchange rates are not compatible with the state of semi-integrated economies achieved so far. Therefore a system of limited intra-Community flexibility combined with joint-floating erga extra is proposed. The creation of a Common European Currency, defined in terms of a bag of national currencies, at an early stage is also advocated. This important step towards monetary unification would, among other things, facilitate the operation of the limitied

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flexibility schedule and promote the liberalization of capital movements by offering an adequate instrument for a truly European unified money and capital market.

To fulfill the functions envisaged for the Common European Currency it must be more than just an instrument for official settlements. It should also become the common intervention currency for stabilising the value of the currencies of member-states on the exchange markets. This implies the introduction of the Common European Currency as a medium in which private transactions can be settled. For these functions it would suffice initially to restrict the use of the Common European Currency to what is called a "monnaie cambiaire". The rôle of the Common European Currency would be comparable to that of the Euro-dollar with possibly supplementary functions.

A new currency, of course, needs an issuing body and pooling of reserves. Even more important is an adequate management to prevent it from becoming another engine of inflation. A decision-taking body in monetary affairs at the European level is thus to be created concomitantly. One of its major tasks would consist in implementing a European money supply policy, including control over national money creation.

3. The progress thus achieved in monetary unification can only be successful and operational if backed by sufficient advance in economic integration to cope with conjunctural and structural imbalances which monetary unification itself might even enhance. In general, however, economic and social integration deserves to be pursued in its own right. It should not be constrained to the minimum rate of advance necessary to accompany monetary unification (and vice versa). Advance in economic union has its own significance. It is more than just an infilling of crevices wrought be monetary union.

Stabilisation policy aiming at a steady rate of growth of GNP with price stability and full employment under a balance of payment constraint becomes more complicated. Conjunctural policy has to be pursued at three different levels: Community, member-state, regional. As compared with the member-state situation, the Community cycle problem is mainly dominated by prices whereas the divergencies

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for regions with declining industries are dominated by additional employment difficulties. For the Community cycle progress towards EMU along the lines advocated in this report offers the right instruments (monetary) to deal with the problem it brings about namely the consolidation of a Community cycle. At any rate, further progress towards monetary unification through narrowing margins for exchange-rate fluctuations would require an increasing synchronization of Community cycles. The emphasis of stabilisation at the member-states level must shift to budgetary instruments. A sufficient degree of flexibility will have to come from the fiscal side. However, this runs counter to some plans for tax harmonisation argued on the grounds of removing distortions to trade and factor movements.

Regional disparities are caused by divergent trends of factor prices and productivity rates, so that "highly" paid labour can no longer be employed by areas or industries with lagging productivity levels. It is likely that EMU will lead to a faster convergence of factor price levels than of productivity trends. This makes the need for a large scale regional policy at the Community level all the more urgent. However, matters are complicated by the difficulty in defining the regional problem, particularly as we are on the threshold of a new concept of the regional problem characterised by congestion and infra-structure run-down and decay. To avoid the situation from becoming unmanageable the list of Community criteria should be kept very short and simple and perhaps be put only in terms of income and unemployment levels.

The schedule for limited exchange rate flexibility supported in this report as part of the transition to EMU would be greatly strenghthened if a better harmonisation of average wage and price increases could be brought about. If exchange rates are ultimately to be rigidly locked incomes policy consistent with remaining productivity differences become indispensable. Trade union co-operation will have to play a big role in this respect. As regards social policy, questions arise as to the required size of an enlarged Social Fund and its mode of use since, with the advent of EMU, the labour consequences of the resultant industrial re-organisation might well attain a new scale Whatever the particular policies adopted in the social field, it is clear that there is no justification for its finance by a system of _juste retour._

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In the field of industrial policies the problem is to select those policies which are the most essential accompaniments of EMU or which are rather inexpensive in terms of costs.

4. Most of the afore-mentioned policy proposals, and indeed the most crucial ones, require substantial financial resources exceeding by far the current Community budget. Therefore, the Community budget should be expanded to, at least, 3 % of the Community GNP by 1980. Perhaps this is the best way to illustrate the great difficulties and resistances which have to be overcome if the objective of an economic and monetary union by the end of the decade is to be transformed into reality.

In general a great gap exists, at present time between offical declarations of intent and the concrete actions undertaken to further progress on econmic integration and monetary unification. It has greatly weakened the credibility of EMU. It is time to recognize that the proclamation of high principles and objectives is not sufficient to guarantee their implementation in economically meaningful and viable schemes. The principles need to be followed up by common policies.

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C O R R I G E N D U M

Page 46, footnote :

* The Commission has proposed using the deficit in the migration of labour force as an additional criterion. Cf. COM(73)1751, 10 October 1973.

Page 47, § 2 :

2) <u>Community Regional Policy and Member-State Regional Policy</u>

It has been stated, in connection with the Commission's report and its subsequent proposals that the Regional Fund will supplement rather than partly replace member-state regional spending.

Page 57, delete the three last lines of the footnote and substitute them by :

With a fraction of 10 % of the C.E.C. in the European money supply the revenue potential of the C.E.C. as a fraction of Community income is

$$\frac{0{,}1 \quad \Delta M}{\text{Community Income}} = \frac{0{,}1\ (0{,}05 + 0{,}05)}{2{,}5} = 0{,}004$$

Page 60, delete § 1 and substitute it by :

1. The development of the Common Market, characterized by the free movements of goods, services and factors of production, into a fully fledged Economic and Monetary union marks an important and perhaps decisive turning point in the building of the European Community. But there should be no delusion : the tasks and objectives still awaiting their fullfilment are by no means easier than the already difficult achievements of the past. The transition from the Common Market approach - which for sure has not yet come to an end - to the creation of an economic and monetary union, implies a shift of emphasis from <u>market integration</u> to an <u>institutional integration.</u> The former is mainly concerned with the abolition of barriers to intra-EC trade and factor movements and the implementation of common policies, particularly vis-à-vis the outside world, whereas the latter concentrates on creating the necessary set-up bound by common political responsibility, for efficient decision taking processes to work toward the common objectives and policies which form the core of EMU.