CARLI REPORT ON E.M.U.

REPORT TO THE EUROPEAN COUNCIL BY MR GUIDO CARLI,
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At their July and September meetings, the Community Finance Ministers paved the way for a solution to the problems involved in achieving economic and monetary union; they also took part in October's inter-institutional meeting. They have discussed the reports submitted by the Monetary Committee and by the Committee of Central Bank Governors and the document approved by the Commission in August, and a smooth start has been made on the preparatory work for the Inter-governmental Conference. They take the view that a broad-ranging consensus exists on the key aspects of the approach that has proven most effective in the past in fostering moves towards closer economic and monetary integration.

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As regards the objective of EMU and the ways and means of achieving it, agreement has been forthcoming on the ultimate aim of economic and monetary union, namely a single currency and a monetary policy based on price stability and conducted by a single monetary authority. Such an approach implies acceptance of a transfer of national sovereignty over monetary policy and acceptance of constraints on fiscal policy.

No No

However, mention should be made straight away of the United Kingdom's divergent view, according to which economic and monetary union may - not must - lead to the introduction of a single currency to replace national currencies and does not require prior recourse to a single monetary policy administered by a single authority; under the impact of market forces, a common currency could, in its opinion, gradually replace existing national currencies.

According to the view shared by all the Member States, except the United Kingdom, the final stage of economic and monetary union will be achieved through the transfer of national powers to a monetary authority responsible for conducting monetary policy. The aim of that policy will be to ensure that the purchasing power of the currency remains stable; measures to support the policy for boosting income and employment would not be ruled out but, in the event of a conflict of interests, price stability would have to take precedence.

A monetary policy of this nature presupposes that the authority conducting it would enjoy complete independence and absolute autonomy. The money supply and interest rates are monetary policy instruments and the authority responsible for maintaining price stability would have to be free to decide on their use.

This has the following implications:

(1) Budget deficits could not be financed, either directly or indirectly through money creation. The central banks would have to be barred from granting governments advances or subsidies. Purchases of government securities could be permitted exclusively on the initiative of the central banks and solely in order to regulate the amount of money in circulation. Similarly, the commercial banks could not be obliged to purchase securities or to finance governments in any other way;

(2) No Member State could benefit from the guarantee afforded by other Member States or by the Community budget in respect of operations to finance its budget deficit;

(3) Excessive deficits would not be permitted. A clear definition of what constitutes an excessive deficit has yet to be agreed on, but work is in progress with a view to reaching a consensus on this point. For some, an appropriate definition could be that deficits should not be allowed to exceed capital expenditure. In other words, public budgets should not be the cause of any erosion of savings;

(4) Another requirement that must be met in order to secure the independence of the Community monetary authority, for which the designation "European System of Central Banks" or "European Central Banking System" is proposed, is that its administrators must be given guarantees as to their independence of judgment and freedom or manoeuvre, must on no account be bound by instructions from any outside party and must, therefore, be protected against dismissal should their actions prove unwelcome to the political authority.

In order to create the necessary structure for the European monetary authority, the statutes of the national central banks will have to be amended in line with the principles of independence governing the system in which they will be participating.

While the European System of Central Banks will have the greatest possible independence in determining the monetary policy to be pursued within the Community in order to ensure price stability, that independence will be limited through the involvement of the political authority when it comes to determining the exchange-rate regime that will exist between the Community currency or currencies and those of non-member countries, in particular the dollar and the yen. Clearly, in determining the exchange-rate regime, the political authority would have to take decisions in consultation with the monetary authority; within the framework of a given regime, intervention policy would be determined jointly by the monetary and political authorities. There are those, however, who take the view that it is solely for the former to decide whether to intervene in foreign exchange markets so as to ensure that exchange rates satisfy the conditions laid down as part of the agreed exchange-rate regime.

In that respect, as with the more general pursuit of economic policy objectives, close co-operation will be necessary between the political authority - as represented by the Council, the Commission and, in its fact-finding role, the Monetary Committee - and the monetary authority, which will invariably be under an obligation to pursue price stability.

The extent of the independence conferred on the European System of Central Banks raises the problem of its democratic accountability. The solution would be to draw up a statute enabling the political authority, which derives its own legitimacy from universal suffrage, to monitor the actions of the monetary authority. Those monitoring powers should be vested in the European Parliament.

As regards the transition from stage one to stage two of the process leading to economic and monetary union and the question as to the duration and substance of stage two, three different positions emerged in Rome in September among the Member States that subscribe to the ultimate objective of EMU:

(1) fixing of a definite date for transition from stage one to stage two; Dutch Spanish

(2) no such date to be fixed; UK

(3) fixing of a definite date, subject to certain conditions being met.

The first two positions spring from differing conceptions of institutional change; both have their roots in the history of European unification: (a) the fixing of a deadline is the most powerful catalyst available for bringing about the changes in behaviour which are a precondition of institutional change; (b) institutional change takes time and must, in any event, be consequent upon a change in behaviour since the approach of a deadline is not necessary for deciding whether the conditions for institutional change are met.

Jean Monnet's memoirs can teach us a great deal here. He said, for example:

> "Events have taught me that human nature proves to be weak and unpredictable when rules are lacking and institutions break down ...... Institutions are greater than men. But only men, when they possess the strength, can change and enrich the things which the institutions then hand on to successive generation ...... Men are essential to change but institutions are vital to see it through".

The question whether the date for transition from stage one to stage two should be 1 January 1993 or 1 January 1994 is not essential; the substance of stage two is certainly more important. Possible compromises under which a date would be fixed and a number of conditions laid down have been put forward in several quarters. Apart from conditions - implicit or explicit - regarding completion of the internal market and the ratification of the amendments to the Treaty of Rome, the conditions mentioned include the following: (a) that all currencies should have joined the exchange-rate mechanism, and even the narrow band; (b) that there should be a ban on monetary or compulsory financing of government deficits; (c) that public saving should not be negative; and (d) that there should be legislation guaranteeing the independence of the central bank, or at any rate of the central bank governors in their capacity as members of the central bank council. As yet there is no unanimous agreement on all of these conditions; progress was made towards a common position in a brief discussion following the inter-institutional meeting and in bilateral meetings. The ECOFIN Council is confident that it will be able to put forward a solution before the Inter-governmental Conference begins, without however giving any country a de facto veto on the changeover to stage two.

The search for a compromise cannot leave out of consideration the United Kingdom's proposal, which accepts the transition from stage one to stage two, rules out the establishment of a European System of Central Banks, proposes the creation of a European monetary fund with the power to issue the "hard ecu" against deposits of national currency, makes the "hard ecu" a unit whose value can change only in terms of national currencies, and proceeds on the assumption that the pressure of market forces will direct the preferences of operators towards increasing use of the "had ecu", which in this way would possibly could ultimately replace the individual national currencies.

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Spain: For Xchange Controls

Inflation Rates 2 - 22½

Int Rates 8 - 18

PSBR -3 to 17%

No For Xchange Controls

Greece
Portugal

? Ireland

On analysis, it is clear that only some of these elements can be considered, mainly with a view to strengthening the ecu. All the Member States, with the exception of the United Kingdom, are convinced that in the process of economic and monetary union only a political decision is capable of influencing the market expectations in a positive direction and of paving the way inexorably towards a single currency, which should be the ecu, suitably reinforced.

The monetary arrangements do not make up the entire substance of economic and monetary union; they also necessitate parallel movement on the monetary and economic fronts and presuppose that the divergences between individual economies will be attenuated, possibly through the use of instruments which could be deployed to accelerate a process aimed at reducing inequalities between Member States.

It should be emphasized, finally, that the Inter-institutional Conference pointed to the need for the Inter-governmental Conference on EMU to be held in parallel with the Inter-governmental Conference on political union. It is vital that there be close contact between the two. As regards the organisation of the EMU Conference, it is worth pointing out that all or almost all of the Finance Ministers are of the opinion that the delegations should be headed by the Finance Ministers and should include representatives of the Foreign Ministries.

Single Financial Area

"Enhanced" Competition Policy.

ERM - narrow band

Completion of Single Market. (100 A)

Next stage agreed unanimously.