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INFO PRIORITY EUROPEAN COMMUNITY POSTS, BERNE, VIENNA

FRAME ECONOMIC

ECONOMIC AND MONETARY UNION: COMMISSION PAPER FOR ECOFIN

SUMMARY

1. COMMISSION PAPER ON EMU FOR INFORMAL ECOFIN FOLLOWS PREDICTABLE LINES, REJECTING THE UK APPROACH AS RISKING SYSTEMIC INSTABILITY. ON MONETARY POLICY IT FOLLOWS THE DELORS REPORT: CENTRAL MONETARY POLICY RUN BY INDEPENDENT CENTRAL INSTITUTION WITHIN FEDERAL STRUCTURE: COMMON CURRENCY (THE ECU): ACCOUNTABILITY TO, BUT NOT CONTROL BY, EUROPEAN PARLIAMENT AND COUNCIL. ON BUDGETARY POLICY, DEPARTS FROM DELORS PRESCRIPTION BY REJECTING BINDING CONSTRAINTS ON BUDGET DEFICITS IN FAVOUR OF BINDING PROCEDURES FOR SURVEILLANCE. SOME MACROECONOMIC ROLE FOR EC BUDGET ENVISAGED.

DETAIL

2. THE COMMISSION'S PAPER ON EMU HAS NOW BEEN SENT TO THE IRISH PRESIDENCY, WHO ARE CIRCULATING IT TO MEMBERS OF MONETARY COMMITTEE TODAY. IT HAS THREE MAIN SECTIONS: THE COSTS AND BENEFITS OF EMU: ANALYSIS OF ALTERNATIVE APPROACHES: AND, THE MAIN BODY OF THE PAPER, DESIGN OF THE PREFERRED SYSTEM.

COSTS AND BENEFITS OF EMU

3. COMPARES FULL EMU WITH THE STATUS QUO (ASSUMING FULL IMPLEMENTATION OF SINGLE MARKET). ARGUES THAT EMU WILL LEAD TO PRICE STABILITY: INCREASED EFFICIENCY THROUGH ELIMINATION OF TRANSACTION COSTS AND EXCHANGE RATE UNCERTAINTY: AN IMPROVEMENT IN THE INTERNATIONAL ECONOMIC BALANCE BY INCREASING THE COMMUNITY'S INFLUENCE ON INTERNATIONAL ECONOMIC AFFAIRS. FULL BENEFITS OF EMU ONLY AVAILABLE WITH SINGLE CURRENCY (AS OPPOSED TO IRREVOCABLY FIXED PARTIES). NO ATTEMPT AT QUANTIFICATION, BUT POTENTIAL IMPACT JUDGED TO BE NO LESS IMPORTANT THAN THE SINGLE MARKET (WHICH WAS ESTIMATED IN THE CECHINI REPORT AS UP TO 5 - 7 PERCENT OF GNP).

4. IT IS STATED THAT, BECAUSE OF THE RISKS OF SYSTEMIC INSTABILITY IN THE TRANSITION PERIOD, THE PASSAGE FROM THE BEGINNING

OF STAGE 1 TO THE DEFINITIVE EMU SHOULD BE RELATIVELY RAPID.

OTHER APPROACHES TO EMU

5. THE PAPER REJECTS THE UK APPROACH OF COMPETING MONETARY POLICIES ON THE ARGUMENT THAT THIS WILL CREATE SYSTEMIC INSTABILITY, DUE TO DIFFERENT MEMBER STATES ADOPTING DIFFERENT MONETARY POLICIES (NO REFERENCE IS MADE TO THE ARGUMENT THAT MARKET FORCES WILL ENSURE THAT COMPETITION WILL BE IN AN ANTI-INFLATIONARY DIRECTION). THE PAPER ALSO REJECTS: MONETARY UNION WITHOUT ANY MOVE TOWARDS ECONOMIC UNION, BECAUSE THIS WOULD PUT TOO MUCH STRAIN ON MONETARY POLICY; AND MONETARY UNION WITH FULL ECONOMIC UNION, SINCE THIS IS NOT NECESSARY TO ACHIEVE THE OBJECTIVE, AND THEREFORE CONFLICTS WITH THE PRINCIPLE OF SUBSIDIARITY.

DESIGN OF PREFERRED SYSTEM FOR EMU

6. THE MAIN LINES OF THE COMMISSION PRESCRIPTION FOR THE FINAL STAGE OF ECONOMIC AND MONETARY UNION ARE PREDICTABLE. THE APPROACH TO MONETARY UNION FOLLOWS CLOSELY THE PROPOSALS IN THE DELORS REPORT:

- A SINGLE COMMUNITY MONETARY POLICY, OPERATED THROUGH A FEDERAL SYSTEM OF CENTRAL BANKS ('EUROFED'), COMPRISING EXISTING NATIONAL BANKS AND A NEW CENTRAL INSTITUTION.
- COMMUNITY MONETARY POLICY AND EUROFED TO BE EXPLICITLY COMMITTED TO PRICE STABILITY, AND, SUBJECT TO THIS, TO THE SUPPORT OF THE GENERAL ECONOMIC POLICY OBJECTIVES OF THE COMMUNITY.
- CENTRAL INSTITUTION INDEPENDENT, CONTROLLED BY A COUNCIL MADE UP OF THE CENTRAL BANK GOVERNORS OF THE TWELVE MEMBER STATES AND A SMALLER NUMBER OF MEMBERS APPOINTED AT COMMUNITY LEVEL.
- ACCOUNTABILITY ENSURED BY REQUIREMENT TO PROVIDE REPORTS TO THE COUNCIL AND TO THE EUROPEAN PARLIAMENT, AND TO APPEAR AT HEARINGS BEFORE THE LATTER.
- EUROFED TO HAVE FULL RANGE OF MONETARY POLICY INSTRUMENTS, AND CONTROL OVER THE ISSUE OF THE ECU (WHICH IS TO BECOME THE SINGLE COMMON CURRENCY).
- NO FIRM VIEW EXPRESSED ON WHETHER EXTERNAL ASPECTS OF MONETARY POLICY (IE EXCHANGE RATE AND INTERVENTION POLICY) SHOULD BE SET BY EUROFED OR BY THE COUNCIL (IE ECOFIN), BUT STRESSES POTENTIAL IMPORTANCE OF EMU IN GIVING THE COMMUNITY A KEY ROLE IN THE MANAGEMENT OF THE INTERNATIONAL MONETARY SYSTEM.

7. ON ECONOMIC POLICY, REJECTS A KEY ELEMENT IN THE DELORS REPORT, BINDING LIMITS ON BUDGET DEFICITS, IN FAVOUR OF:

- NO MONETARY FINANCING OF PUBLIC DEFICITS:
- NO BAILING OUT OF MEMBER STATES (BUT NOT EXCLUDING AD HOC

CONDITIONAL ASSISTANCE),

- BINDING PROCEDURES FOR ENSURING CONVERGING BUDGETARY POLICIES, EMBODYING THE 'BID AND OFFER' SYSTEM WHEREBY EACH MEMBER STATE WOULD SET OUT THE RULES AND LIMITS THAT IT WOULD BE PREPARED TO COMPLY WITH, WITH THE ADEQUACY OF THESE RULES TO BE DISCUSSED AND AGREED AT COMMUNITY LEVEL. THERE WOULD BE 'INSTRUMENTS OF GRADUATED COMMUNITY RESPONSE' IN THE EVENT OF NON-COMPLIANCE (RESPONSE TO NON-COMPLIANCE TO BE FURTHER DEVELOPED IN THE CONTEXT OF THE DISCUSSION ON INSTITUTIONAL QUESTIONS).

8. THE SECTION ON ECONOMIC POLICY ALSO IDENTIFIES POLICY AREAS WHERE COMMUNITY INVOLVEMENT SHOULD INCREASE, AND PUTS THE CASE FOR A BIGGER ROLE FOR THE COMMUNITY BUDGET. POLICY AREAS IDENTIFIED ARE: COMPETITION POLICY, COMMERCIAL POLICY, RESEARCH AND DEVELOPMENT, EUROPEAN-WIDE INFRASTRUCTURE, LABOUR MARKETS AND THE ENVIRONMENT.

9. THE COMMUNITY BUDGET WOULD HAVE TO GROW TO FINANCE EXPENDITURE IN THESE AREAS, TO COVER POSSIBLE STRENGTHENING OF COMMUNITY STRUCTURAL POLICIES (INCLUDING DEVELOPING A MECHANISM FOR MAKING FINANCE AVAILABLE TO REGIONS EXPERIENCING UNEXPECTED ECONOMIC SHOCKS), AND TO GIVE THE COMMUNITY BUDGET A ROLE IN 'RE-ENFORCING THE SURVEILLANCE PROCESS'. THE PAPER ENVISAGES INTRODUCING COMMUNITY BORROWING TO FINANCE BUDGET EXPENDITURE, AND 'AN INCREASED CAPACITY ON THE REVENUE SIDE OF THE EC BUDGET'. (COMMENT: THE COMMISSION HAVE CLAIMED TO US THAT THE INCREASE IN THE COMMUNITY BUDGET'S ROLE WOULD BE ONLY MARGINAL, AS DELORS HAS ALWAYS ARGUED).

NEXT STEPS

10. THE COMMISSION ARE NOT PRESSING FOR THIS PAPER TO BE DISCUSSED BEFORE THE INFORMAL ECOFIN, BUT WOULD NOT OBJECT TO A DISCUSSION. THE PRESIDENCY IS NOT CURRENTLY INTENDING TO SCHEDULE ANY PRELIMINARY DISCUSSION. THE PAPER WAS SENT TO BOTH REYNOLDS (FINANCE MINISTER) AND COLLINS (FOREIGN MINISTER) SO A DISCUSSION IS ALSO LIKELY AT THE NEXT FAC. COMMISSION PAPER ON INSTITUTIONAL ASPECTS OF EMU IS STILL UNDER PREPARATION, AND THE COMMISSION ARE ALSO DOING WORK ON THE MECHANISM FOR MOVING FROM THE CURRENT POSITION TO FULL EMU.

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