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INSTITUT MONETAIRE LUXEMBOURGEOIS

LE DIRECTEUR GENERAL

Luxembourg, le 6 mars 1989

Monsieur Jacques DELORS
Président
Commission des Communautés Européennes
200, rue de la Loi
B - 1049 BRUXELLES

Dear President,

I understand from your letter dated 3 March 1989 that the forthcoming meeting of the Committee for the Study of EMU on 14 March in Basle will be dedicated to the detailed discussion of part III of the draft report.

This means that, with the April meeting being our last meeting, there will be no opportunity to examine together part I on the basis of a redraft following a first discussion by our committee.

For this reason I want to give you, well in advance of our last meeting, my sentiment on the draft of part I in its present version dated 2nd March 1989 (CSEMU/12/88).

Generally my preference would be for a much shorter text limited to the following elements:

(1) Past undertakings in the direction of EMU (paragraph 1. of the draft)
(2) The EMS and the adjustment of Member Countries Policies (the contents of paragraphs 3., 4. and 5 in a somewhat shortened version)
(3) The basic difference between the EMS and EMU with regard to policy decision making (the

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draft for some paragraphs of this section are added as an annex to this letter).

I would suggest to drop most if not all of paragraphs 6 through 18 of the draft of 2nd March 1989 because I doubt wether the European Council gave us a mandate to examine or is interested in our views on the parturition of the internal market and the advantages it is expected to bring to the citizens of Member Countries.

These things have already been well said by others. They are by nature an amalgam of analysis, evaluation, belief and vision. Insofar they are well suited for political leaders.

Paragraphs 6 through 18 by adressing the issue of the internal market at such great lenght might suggest that progress towards EMU is necessary for the achievement of the internal market or will have to result with some necessity from the internal market. If the committee wishes to address this interesting question, I think it should do so in an open and explicit way under a separate and clearly identified point in part I. (to be inserted for example between points (2) and (3) of the structure suggested above).

My understanding of the mandate "to study and propose concrete stages leading towards economic and monetary union" is more literal in a way that we should show how EMU would have to work in practice and to point out the main differences with regard to the present functioning of policy making at the level of the Community and its Member Countries.

For this reason I have in our past discussions repeatedly expressed the view that we should refrain from making assertions and judgements of a general nature about matters of appreciation which

go well beyond a straightforward reading of our mandate.

Again for this reason I think that the Committee has, for the sake of intellectual honesty, to draw the attention of the European Council to the fundamental differences in policy decision making under the conditions of the EMS, where surveillance and corrective pressures come from the markets, and EMU where the key element is the quality of common analysis and policy coordination.

This point is quite crucial in my view since the experience with surveillance and policy coordination in the past is mixed, to put it mildly and with the deliberate will to ignore the bizarre results of twenty years of close and binding coordination and a profusion of directives in the field of common agricultural policy.

I am aware that this point is briefly touched upon in the present draft in paragraphs 16 and 29 but in my view it is belittled and drowned. My clear preference would be to have it in a more visible place i.e. either in concluding remarks (to be drafted eventually) or in the introduction as I am suggesting, given the present structure of the report.

Yours sincerely,

Pierre Jaans

(Pierre Jaans)

Annex 6.3.1989

The basic difference between the EMS and EMU with regard to policy decision making.

In the EMS policy decisions in the field of monetary, economic, fiscal and budgetary policies are of the competence of national authorities. The constraint is limited to central rate changes, which are subject to a consensus of the countries participating in the ERM.

National policy decisions are taken autonomously, sometimes after consultations which may or may not entail adjustments in planned decisions.

The main source of short-term surveillance and sanction under this system is the foreign exchange market and the balance of payments performance. If the stance and mix of policies is credible to the market, the chosen exchange rate will not come under attack. If the policy cocktail lacks credibility in the market or if the balance of payments performance falters, the market will rapidly exert strong pressures for policy adjustments.

Foreign exchange markets may at times be affected by misjudgements leading to a significant overshooting. This has been the case in particular with the U.S. dollar market because of the world reserve character of that currency. In the case of those European currencies, however, which have no significant reserve currency rôle, the foreign exchange markets have in general not developed into lasting misalignements not warranted by fundamentals.

In other words, the adjustments in central rates in the EMS which have been over time decided under the monitoring and sometimes under the pressure of foreign

exchange markets have not lead to a pattern of rates affected by severe imbalances.

Thus it can be said that, in the case of currencies participating in the ERM, foreign exchange markets have performed a helpful function of discipline and guidepost for policy shaping and decision making. The relative success of the EMS owes a great deal to this factor since in the case of some countries participating in the ERM fundamental reorientations of policy choices were greatly accelerated through the acceptance of market pressures, the alternative of taking leave from the EMS not being considered as politically viable.

With the transition to EMU, characterized by a centralized monetary policy for a single currency or a set of currencies with irrevocably fixed parities, the monitoring rôle of foreign exchange markets and of balance of payments performances will by definition cease to exist.

Decision making in monetary policy and in certain key areas of fiscal and budgetary policies will be centralised and will have to be built on a majority based consensus on analysis, on evaluation and on the choice of means. Member countries will however retain a significant portion of residual autonomy in the field of economic and budgetary policies.

Under these conditions misalignments between centrally decided policies and policies decided at the national levels, or coordinated but erroneous policy choices at both levels will no longer be signalled by foreign exchange markets. Similarly payments disequilibria will be dedramatized since in an EMU they are no longer accompanied by a depletion of foreign exchange reserves.

Thus the identification of misalignments may be delayed either involuntarily or voluntarily for political reasons. As a result regional disequilibria, more

severe and lasting losses of competitiveness and unemployment or involuntary emigration may develop before a new consensus about corrective action would be reached either at the central or the national level of policy making or both levels.

In principle and to the extent that the Community would over time develop into a policital union, these difficulties could eventually be overcome by learning from errors and by growing political and social cohesion and solidarity.