The Path to European Monetary Union

By Paula Hildebrandt

In a period of unprecedented change in Europe, European monetary union has emerged as one of the most important new developments. Europe 1992 is already creating a market with more than 320 million consumers and a productive capacity rivaling that of both the United States and Japan. European monetary union would go even further, implementing a unified European monetary policy.

The 12 member-countries of the European Community are currently debating the Delors Report, which outlines a three-step approach to economic and monetary union (EMU) in Europe. The first stage includes the Europe 1992 initiative and has already been accepted. Stages two and three are still being negotiated. They would form a single European central bank and currency.

This article discusses the movement toward monetary union in Europe. The first two sections lay the historical background for EMU and describe the proposed stages of the Delors Report. The next section provides a detailed description of the European System of Central Banks envisioned in the Delors Report. The article then discusses some of the important issues being debated. A glossary of frequently used terms is included at the end of the article.

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Historical Developments Leading to EMU

EMU is not the first attempt to unite Europe. For nearly 40 years, Europeans have sought greater economic and monetary cooperation. From the first "common market" in 1952 to current plans for Europe 1992 and EMU, the Europeans have strived to create a "Europe without barriers."

Foundations of economic union

Economic cooperation in Europe dates back to 1952. France, Italy, West Germany, Belgium,

the Netherlands, and Luxembourg banded together to form the European Coal and Steel Community. This "common market" for coal, steel, and iron ore made trade between members easier by eliminating costly tariffs normally placed on these imported goods.

The success of the European Coal and Steel Community prompted members to create the European Economic Community (EEC), formalized by the Treaty of Rome in 1957. The EEC extended the common market to include all goods. By eliminating tariffs, the EEC moved a step closer to economic union.

The European Community (EC), as the EEC was later called, decided in 1969 to pursue complete monetary union.[1] Plans to achieve union were drawn up in the Werner Plan, commissioned by the EC Council of Ministers and adopted in 1971. The Werner Plan established that within ten years exchange rates between EC countries would become fixed and the members would follow a common monetary policy. As an initial step, members were required to keep exchange rate fluctuations limited to designated ranges, called margins. The plan was discarded, however, when the 1973-74 oil price shocks caused many members to abandon the exchange rate margins. The oil price shocks had led to higher and more divergent inflation rates, making the exchange rate margins difficult to maintain (International Monetary Fund).

Momentum for monetary coordination returned in 1978 with the development of the European Monetary System (EMS). The EMS established the Exchange Rate Mechanism (ERM), which bound members to maintain exchange rates within narrow margins. The EMS remains in place today. EMS members include the 12 current EC members: Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, and the United Kingdom. Currencies for most members currently fluctuate within a 2¼ percent band. Two members of the EMS—Portugal and Greece—still do not participate in the ERM. Two other members—the United Kingdom and Spain—only recently joined the ERM and allow their currencies to fluctuate in 6 percent margins. Although realignments occurred often in the early days of the ERM, exchange rates within the ERM have become increasingly stable (Ungerer).

Europe 1992

Trade barriers still existed in the 1980s, although tariffs were gone and exchange rates had become increasingly stable in the EC. Safety and environmental standards in many EC countries, for example, continued to restrict foreign competition. Similarly, subsidies to inefficient industries combined with capital and border controls to impede cross-country trade. These barriers reduced the efficiency of European markets, lowering the potential for economic growth.

Slower economic growth in the Community and strong international competition from the United States and Japan renewed interest in further integration. This renewed interest led to the Single European Act in 1985. Commonly known as Europe 1992, this act was designed to eliminate all barriers to the movement of persons, goods, services, and capital between member-countries by the end of 1992.

Once Europe 1992 is fully implemented, Europeans will enjoy a variety of economic benefits. Both people and firms will benefit from lower costs in transactions. For example, people will be able to travel throughout the EC without being detained at borders. Firms will be allowed to ship goods anywhere in the EC without facing a myriad of safety and environmental standards. Laws will be standardized in many industries, including the telecommunications and automobile industries. Such laws will

make it possible for firms to expand and be more efficient in the larger, single market. And Europe 1992 will create a single financial area. A single financial area will allow money to flow freely throughout the Community and allow banks to locate branches anywhere they choose. In short, Europe 1992 will substantially increase economic integration, while providing EC countries with a greater potential for economic growth and a higher standard of living (Bennett and Hakkio).

Economic and monetary union

Europe 1992 and the success of the EMS have renewed interest in greater monetary integration. EC members believe a unified monetary policy will enhance the benefits of Europe 1992 by forcing member-countries to adopt a common anti-inflationary stance and by reducing the costs of exchange rate fluctuations and uncertainty. Hence, members believe monetary union will further increase efficiency and economic growth (Directorate-General).

With momentum building toward economic and monetary union, the European Council formed a committee to develop concrete stages for complete monetary union. In April 1989, the committee presented to the Council the "Report on Economic and Monetary Union in the European Community," commonly referred to as the Delors Report. In June of the same year, the member-states approved both stage one of the Delors Report and the goal of economic and monetary union. Stages two and three have not yet been approved by EC members and are currently being discussed at the intergovernmental conferences on EMU.[2]

The Delors Report on Economic and Monetary Union

The Delors Report offers a concrete, step-by-step approach to economic and monetary union in Europe. According to the Delors Report, *economic union* will occur with the completion of Europe 1992 and the coordination of macroeconomic policies, including policies concerning the size and financing of government budget deficits. *Monetary union* will occur when EC members come to share a common European monetary policy set by a unified central banking system called the European System of Central Banks (ESCB), and when a single currency replaces the 12 member-nation currencies.

The Delors Report outlines three stages to reach unification. Stage one promotes greater economic convergence. Stage two will serve as a transition period by setting up a single European central bank. Stage three will introduce a common monetary policy and a single currency.

Stage one

Stage one, launched officially on July 1, 1990, promotes greater economic convergence by increasing economic and monetary cooperation. A recurring theme throughout the Delors Report is that large differences in economic growth, inflation rates, or budget deficits among the member-states would make integration difficult. For example, the currency of a country suffering rising inflation would be under pressure to depreciate, making the move to fixed exchange rates difficult. Consequently, the EC wants member economies to "converge," or become more similar, before moving to a single currency and central bank. To foster economic convergence, stage one sets goals to encourage economic and monetary cooperation. Stage one will also revise the EC's founding treaty to accommodate new Community institutions.

Four goals of stage one are designed to

promote economic convergence. The first of these is to complete Europe 1992. By eliminating barriers to trade and finance, Europe 1992 will effectively create a single internal market in Europe.

A second goal is for EC members to trim government budget deficits. The EC believes large budget deficits hinder stable exchange rates, making the move to irreversibly fixed exchange rates difficult. To discourage continued deficit spending, the EC's Council of Finance Ministers will assess national economic conditions and policies. During stage one, the Council may only recommend policy corrections; however, national governments are supposed to consult with the Council before making any major policy changes.

A third goal is to provide additional resources for regional and structural development. Stage one allows for financing economic development in the least developed countries, such as Greece and Portugal. For example, if funds are needed to improve roads and railways or to meet new environmental and safety standards to successfully compete in a European market, the EC will offer assistance.

A fourth goal is to promote economic convergence by increasing monetary cooperation. The Delors Report plans to achieve this goal by strengthening the Exchange Rate Mechanism. One way to strengthen the ERM is to have all member-countries participate (currently Portugal and Greece do not). Another way is to create subcommittees within the Committee of Central Bank Governors to monitor foreign exchange, monetary, and bank supervision policies. During stage one the subcommittees will only offer guidelines to national governments, rather than play an active role in policy.

In addition to fostering economic convergence, stage one has another important goal: to revise the Treaty of Rome, which established the European Community in 1957. Because stages two and three require new Communitywide institutions, the Treaty of Rome must be revised to accommodate them. Otherwise, the last two stages of the Delors Report cannot begin. Revisions to the Treaty of Rome and negotiations on stages two and three of the Delors Report are underway at intergovernmental conferences on European Economic and Monetary Union. These meetings, which began last December, are expected to continue through most of this year.

Stage two

The Delors Report identifies stage two as a brief, transitional phase to prepare the Community for collective decision making in stage three. Tentatively scheduled to begin January 1, 1994, stage two would reform existing institutions and create new Communitywide institutions, such as a central banking system. In addition, the Community would continue to promote economic integration by removing any remaining barriers to trade not already eliminated in stage one. Although Europe 1992 is scheduled for completion in stage one, the Delors Report noted that some revisions or improvements in the Europe 1992 program may be necessary in stage two. As the EC continues to integrate, economic convergence will increase, easing the move to a single monetary policy.

The details of stage two are currently being debated at the intergovernmental conferences on EMU. According to the Delors Report, a major goal of stage two would be to establish the European System of Central Banks (ESCB). The ESCB will include the European Central Bank and the 12 national central banks and will be an important step toward a common European monetary policy. With price stability as its main objective, the ESCB will be independent from both the national governments and organizations at the Community level.

During stage two, the ESCB will assume responsibility for the ERM. The exchange rate margins within the ERM will narrow from the current $2\frac{1}{4}$ percent. Exchange rate realignments will be allowed only in emergency circumstances. The 12 national central banks will still be responsible, however, for their individual monetary policies during stage two.

Stage three

Like stage two, stage three of the Delors Report is currently being debated at the intergovernmental conferences. If approved, stage three of the Delors Report would complete economic and monetary union, transferring important powers from national governments to the Community.

Economic union will give the Community three new powers. First, the Community will assume a larger role in allocating funds for economic development. For instance, if a particular country has trouble adjusting to economic union, the EC will offer financial assistance to make the country more competitive. However, the EC may require policy changes before providing funds if it suspects a country's difficulties stem from misguided policies.

The second new power relates to international affairs. New Communitywide institutions will determine international policy decisions for the entire EC, representing a shift in power from national governments to the Community. On international issues, a single Community view will be expressed, instead of separate views for Germany, France, and so on. The Commission believes Europe will have more influence internationally if it speaks with a single voice.

The third new power that economic union will give the Community is the right to monitor national budget policies. While the Community will not set binding rules about budget deficits, the Delors Report proposes that "excessive" budget deficits will have to be avoided.[3] In addition, national governments will not be permitted to finance budget deficits by printing money.[4] Finally, if a country defies the budget recommendations of the Council of Finance Ministers, the country could face sanctions or have Community financial assistance made conditional on economic policy changes.

Monetary union will give the Community two additional powers. First, the ESCB will assume sole authority for monetary policy. National central banks will no longer be able to pursue individual policies; instead, each central bank will operate under a common monetary policy set by the ESCB's governing council. Annual money supply targets, for example, will be set for each EC country by the European Central Bank.

Second, the Community will assume sole authority for exchange rate policy. In the initial phase of stage three, exchange rates of member currencies in the ERM will be irreversibly locked. This system of fixed exchange rates will continue until it is administratively feasible to introduce a single European currency, tentatively called the ECU.

This "new" ECU would be fundamentally different from the current ECU. The current ECU (pronounced ek' coo) is a basket currency used in accounting transactions. Its value reflects a weighted average of the Deutschemark, the French franc, and the rest of the EC currencies. The ECU is at present strictly a unit of account—there is no physical ECU currency.[5] The new ECU will be a physical currency that replaces the existing individual currencies of the 12 EC members as a medium of exchange.[6] The ESCB will issue these new ECUs in accordance with its monetary policy objectives. In addition, the ESCB will handle all foreign exchange interventions against non-EC currencies, according to policies set within the Community.

Organization and Function of the ESCB After EMU

While the Delors Report outlines the basic features and functions of the ESCB, the Committee of Central Bank Governors has worked out the details. The Committee drafted a statute outlining the specific features, objectives, and functions of the system. Presented at the intergovernmental conference on EMU in December 1990, the draft statute is currently being discussed by conference participants. Like the Delors Report, the statute is only tentative. It too must be approved by the member-states before being added to the revised Treaty of Rome.

Organization and principles of the ESCB

The statute outlines a federal system of central banking modeled after the German Bundesbank and the U.S. Federal Reserve System. The ESCB will consist of the European Central Bank and the 12 national central banks. Important in the organization of the ESCB are three principles—independence, accountability, and subsidiarity.

Independence. Independence is a basic element in the plans for the ESCB. The statute states that the ESCB should be independent of both national and Communitywide politics and have "unequivocal commitment to maintain price stability as the primary objective of the System." Such features have been underscored by Bundesbank President Poehl, for example, who has repeatedly stated that his approval of the European Central Bank depends on its being independent and as firmly committed to fighting inflation as is the Bundesbank (Marsh 1990b).[7]

Accountability. While independence of the ESCB is desirable, the Committee recognizes the need for democratic checks and balances. Therefore, the European Central Bank will be required to submit an annual report to the European Council summarizing the monetary policy actions and other activities of the ESCB during the previous year. The European Central Bank will also have to distribute financial statements and other activity reports on a regular basis to interested parties. Finally, independent auditors, approved by the EC, will examine the European Central Bank and the national central banks.

Subsidiarity. Under the principle of subsidiarity, "functions that can be effectively carried out at a subordinate level should be performed by the subordinate rather than by a dominant central organization." In the context of the Community, subsidiarity means that the European Central Bank should only assume powers that require collective decision making. All other powers or responsibilities should remain with the national central banks.

When assigning tasks in the ESCB, the draft statute adheres to the principle of subsidiarity. For example, a single monetary policy and currency could not be maintained if all central banks acted independently—a central decision-making body is essential. Consequently, the European Central Bank will formulate monetary policy for the Community. However, other responsibilities, like supervising banks, could be executed at the national level, provided that Community guidelines are followed.

Functions of the ESCB

The ESCB's functions will include formulating monetary policy, managing reserves, supervising banks, maintaining the payments system, and implementing the Community's foreign exchange rate policy. Three ESCB groups will perform these functions: the Executive Board, the 12 national central banks, and the Council.[8] The Executive Board will consist of six members selected for their expertise in

banking or monetary matters. One member will be designated the president and another the vice president of the system. Together, the six members of the Executive Board and the 12 governors of the national central banks will form the Council.

The Council. Formulating monetary policy for the EC will be the main duty of the Council. This duty will include determining monetary targets for each member-country. The Council will also establish guidelines for implementing its policy decisions.[9]

The Executive Board. The Executive Board will be responsible for day-to-day implementation of monetary policy. The Executive Board will monitor economic developments by tracking money supplies, interest rates, and exchange rates. Additionally, by buying and selling securities in the open market, the Executive Board will be able to influence the money supplies to meet monetary objectives set by the Council.

The Executive Board will also perform other duties. For example, the Executive Board will issue the ECU, the new European currency. To obtain ECUs, all member banks will have to deposit a portion of their reserves with the ESCB. The Executive Board will implement the exchange rate policy set by the European Council of Finance Ministers. The Executive Board will also provide regulations on bank supervision and the payments mechanism and will coordinate statistical research in the ESCB. Finally, the Executive Board will delegate responsibilities to the member central banks. For example, the Executive Board may ask the 12 central banks to issue notes or help gather statistical information.

The national central banks. The 12 national central banks will assist the Executive Board in carrying out the operations of the System. The draft states that the national banks should, as much as possible, be the "operational arms of the System." Under the Executive Board's instructions, national banks may participate in activities that include issuing ECUs, managing reserves, supervising banks, facilitating the payments mechanism, and lending to credit institutions. National central banks may even be asked to buy and sell securities in the open market or to intervene in the foreign exchange markets.

The national central banks will have additional responsibilities. For example, as members of the Council, central bank governors will help formulate monetary policy for the Community. Each central bank will conduct research and statistical analysis. And, the draft statute states that national central banks may perform other functions outside those of the System, so long as the activities do not interfere with the goals of the System.

The Delors Report: Issues Under Debate

Not all EC members believe the Delors Report represents the best approach to EMU. In the debate over the details of stages two and three at the intergovernmental conferences on EMU, three primary questions have emerged: What is the best way to implement a unified monetary policy in the EC? How quickly should EC countries proceed with EMU? And, how should national budget policies be coordinated and foreign exchange rate policies be executed?

Implementing a unified monetary policy

Since EMU discussions first began in 1989, the United Kingdom has expressed concern about moving to a single currency and central bank. The United Kingdom opposes the loss of national sovereignty involved in the Delors Report's approach to a single monetary policy, fearing it would lead to a loss of control over

U.K. economic policy. For example, after monetary union occurs, national central banks would be unable to set national goals for monetary policy, thus denying national governments a policy tool for stabilizing the economy.[10]

U.K. prime minister John Major has presented an alternative to stage two of the Delors Report. Commonly known as the "hard ECU" plan, Major's alternative would introduce a thirteenth currency, the hard ECU, to compete in the market with the existing 12 national currencies. The hard ECU's value would be linked to the strongest national currency and would never be devalued—features Major believes would make the hard ECU noninflationary. The hard ECU would be issued and managed by a new Communitywide institution called the European Monetary Fund. Management of the national currencies would remain with the national governments. Because the hard ECU would never be devalued, Major believes it would be relatively attractive to businesses. If so, the hard ECU might eventually eliminate demand for national currencies.

Proponents of the hard ECU plan stress the benefits of the market-driven approach to monetary union. By gradually becoming the only currency used, the hard ECU would avoid the risk of fixing exchange rates before adequate economic convergence has developed. The hard ECU plan would also provide central bankers with experience in a common currency before moving exclusively to a single currency. Moreover, because the hard ECU would never be devalued against national currencies, proponents believe the European Monetary Fund would gain credibility as an inflation fighter (Flemming).

The hard ECU plan initially met with strong criticism. Germany was particularly critical—suspecting that adding another currency to the existing 12 would compound the difficulties of coordinating monetary policy. Bundesbank President Poehl opposes the hard ECU, fearing it would be inflationary, despite Major's claims to the contrary (Alterman).

Other members, while less critical than Germany, have expressed additional concerns about the hard ECU plan. Some question the need to introduce a thirteenth currency when the basket ECU already exists. Others claim the hard ECU plan fails to specify conditions that would allow a move to stage three—that is, they fear the hard ECU plan would keep the EC in stage two indefinitely (Ungerer). Still other critics doubt the hard ECU will be able to eliminate other currencies since member-nations have shown no signs of abandoning their own currencies, even though they now may use the currency of their choice.

Since the intergovernmental conferences began in December, signs of compromise have developed. The United Kingdom has indicated that perhaps the ESCB, instead of the European Monetary Fund, could manage the hard ECU (Buchan and Marsh). In addition, both Spain and France have introduced draft treaties that combine features of the Delors treaty and the hard ECU plan. Both treaties plan to increase the role of the basket ECU currency (as opposed to introducing a new hard ECU), with the belief that it would eventually "harden" and become the single currency (McCune).

EMU timing

Issues have also arisen over the timing of EMU. One debate centers on whether to take a slow or fast approach to EMU. The other centers on whether all 12 EC members should proceed with EMU at the same time.

Slow track or fast track to EMU. While the United Kingdom and Germany disagree about the hard ECU plan, they agree that greater economic convergence should come before moving to complete EMU. Both feel that

monetary union before adequate economic convergence would be difficult to sustain (Ungerer). U.K. Prime Minister Major supports a slow, market-oriented approach to EMU, in contrast to the union by legislative fiat called for by the Delors Report. German Chancellor Kohl has insisted that "convergence in economic and budgetary policies" is necessary before moving to a single European currency.[11] To provide more time for convergence and time to prepare adequately for a single currency, Kohl also suggests delaying establishment of the ESCB until 1997—three years later than originally planned (Marsh 1991; *The Economist* 1991).

While the members that favor a slow path to EMU believe economic convergence is necessary for monetary union, other members think monetary union would itself foster economic convergence. France and Italy, for example, would like a quick move to monetary union. In France's draft treaty proposal, stage two would begin January 1, 1994. By the end of 1997, the EC would determine whether a single currency were feasible. If so, detailed plans for the introduction of a single currency would then be devised (BIS).

Two-tier plan to EMU. The "two-tier" plan (sometimes called the "two-speed" plan) raises questions as to whether all 12 EC members need to proceed with EMU at the same time. As noted earlier, the idea that full economic and monetary union requires economies to have similar inflation rates, living standards, and economic growth rates prevails throughout the Delors Report.[12] Because it may take some time to reduce the differences that currently exist between some regions, the "two-tier" plan proposes that countries already sharing similar economic performances—for example, Germany, France, Belgium, Luxembourg, and the Netherlands—proceed with monetary union. The other countries would be left behind until their economies are in better condition for union (Nelson and Roth).

Countries with high inflation rates—like the United Kingdom and Portugal—oppose the "two-tier" approach.[13] These countries fear they might lose power and prestige by not being part of the first group in monetary union. Once the first group experiences the benefits of monetary union, it may be even more difficult for the second group to "catch up." Opponents of the two-tier plan argue the tension it would create between countries would hinder complete economic and monetary union (Marsh 1990a).

Additional macroeconomic issues in EMU

In addition to questions about a single currency and the pace of EMU, EC members have raised other issues. In particular, how much control should the Community have over national budget deficits? And what role should the ESCB play in foreign exchange rate policy?

Budget policies. In the Delors Report, the Community would recommend budget corrections, but not set binding rules on budget deficits. However, some members believe the budget policies outlined in the Delors Report are insufficient. Germany and the Netherlands, in particular, want binding budgetary rules set by the Community. Without such rules, they argue, the stronger members would bear the financial burden of bailing out heavily indebted members (*The Economist* 1990).

Foreign exchange rate policies. The Executive Board's role in exchange rates has also caused some disagreement. In the Delors Report, the ESCB executes foreign exchange rate policy for the single European currency vis-a-vis non-EC currencies, according to guidelines set by the Community. Some committee members, however, believe the Executive Board should play a more active role. Since

foreign exchange rate policy and monetary policy affect each other, some members think the Community's exchange rate policy should at least be subject to the approval of the ESCB. Other members go further, suggesting the ESCB should formulate foreign exchange rate policy (Draft Statute).

Conclusion

Intergovernmental conferences are underway to finalize plans for EMU. At the conferences, EC members are debating the Delors Report and a draft statute on a European central banking system.

The Delors Report, the main proposal for EMU, outlines a three-stage approach to economic and monetary union in Europe. By promoting greater economic and monetary cooperation, stage one plans to increase economic convergence, easing the transition to unification. Stage two would serve as a transitional period, setting up the European Central Bank. Stage three would complete EMU. It involves a move to a common monetary policy and a single currency.

Building on the Delors Report, the Committee of Central Bank Governors drafted a statute on the European System of Central Banks. According to the statute, the ESCB would assume sole authority for monetary policy once EMU is completed. The ESCB would be independent and pursue price stability as its main objective. The Council, the Executive Board, and the 12 national central banks would divide the ESCB's responsibilities, which include formulating monetary policy, executing foreign exchange rate policy, managing reserves, supervising banks, and maintaining the payments system.

Debates have begun over several points of the Delors Report. Issues like the introduction of a single currency, the timing of EMU, and the transfer of powers from national governments to the Community must be overcome. But Europeans are getting closer to their goal. After nearly four decades, economic and monetary union is in sight.

A Glossary of Common Terms

Bundesbank. The central bank of Germany.

Council. The decision-making group for monetary policy in the ESCB. The Council consists of the six members of the Executive Board and the 12 Governors of the national central banks.

Council of Finance Ministers. An EC group consisting of the finance ministers of each member-nation. Sometimes referred to as ECOFIN. After EMU, the Council of Finance Ministers will determine the foreign exchange policy for the Community.

Delors, Jacques. President of the European Commission and chairman of the committee that developed the Delors Report.

Delors Report. The general name for the report entitled "Report on Economic and Monetary Union in the European Community," written by Jacques Delors. The report outlines the stages in economic and monetary union.

EC. European Community. The members include: Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, and the United Kingdom.

ECU. European currency unit, pronounced "ek' coo." The ECU is now primarily a unit of account. The Delors Report recommends that the ECU eventually become the currency used in day-to-day transactions throughout the EC .

EEC. European Economic Community, later called the European Community. The EEC created a common market for all goods traded between members.

EMS. European Monetary System. Formed in 1979, the EMS is the name used to describe the current system of monetary cooperation.

EMU. Economic and monetary union, pronounced "ee' moo." According to the Delors Report, economic union means removing barriers to trade. Monetary union means creating a European central bank (ESCB) and a single European currency.

ERM. Exchange rate mechanism. The ERM provides the rules for setting and realigning exchange rates.

ESCB. The European System of Central Banks. The Delors Report recommends creating a European central bank that would be responsible for setting European monetary policy.

Economic and monetary union. See EMU.

Europe 1992. The EC program that abolishes all barriers to trade, commerce, and travel by December 31, 1992.

European Coal and Steel Community. A common market for coal, steel, and iron created in 1957.

European Community. See EC.

European Council. A decision-making group within the EC. All member-countries have representatives on the Council.

European Currency Unit. See ECU.

European Economic Community. See EEC.

European Monetary Fund. According to the United Kingdom's "hard ECU" plan, the European Monetary Fund would manage the hard ECU.

European Monetary System. See EMS.

European System of Central Banks. See ESCB.

Exchange rate mechanism. See ERM.

Executive Board. One of the three groups of the ESCB. Responsibilities of the Executive Board will include implementing monetary and exchange rate policies and issuing ECUs. The Executive Board will consist of six members selected for their expertise in banking or monetary matters.

Governor. The title for the executive officer of each national central bank.

Hard ECU plan. An alternative to the Delors Report, put forth by the United Kingdom. The plan recommends creating a thirteenth currency, the hard ECU, to compete with and eventually replace national currencies.

National Central Banks. The institution in each of the 12 EC countries responsible for formulating monetary policy. Once EMU occurs, the national central banks will become part of the ESCB.

Single European Act. The 1985 act commonly referred to as Europe 1992. See Europe 1992.

Stage One. The first step of EMU in the Delors Report. The goal of stage one is the continuation of economic and monetary integration.

Stage Two. The second step in the Delors Report. Stage two is an interim stage, used to prepare the EC for moving to collective decision making.

Stage Three. The final step in the Delors Report. Stage three completes EMU with European monetary policy set by the ESCB and a single European currency.

Subsidiarity. The principle of subsidiarity states that national authorities will retain all powers except those that require collective decision making; the latter will be vested in EC-level institutions.

Treaty of Rome. The 1957 treaty establishing the European Community.

Two-tier plan. An alternative to the Delors Report, put forth by Germany and France. The plan recommends that countries with similar economic performance form their own monetary union; other countries are left behind until their performance is similar to the original group.

Werner Plan. The 1970 plan for monetary union. Oil price shocks in 1973-74 led the EC to abandon the Werner Plan.

Endnotes

[1] The EC's interest in monetary union was in part due to growing instability under the Bretton Woods system during the late 1960s.

[2] Since June 1989, the Delors Report has occasionally been revised. This article is based on the most recent version of the Delors Report, which was presented at the intergovernmental conferences in December 1990.

[3] Not everyone agrees that national budget deficits are an impediment to EMU (Mussa).

[4] Even before a single currency is introduced, EC members are strongly urged not to finance their budget deficits by increasing the money supply. Once a single currency is introduced, financing budget deficits by issuing money will not even be feasible. The European Central Bank will issue the currency to EC members.

[5] For example, central banks currently use the ECU as a reserve asset and for settling accounts, while some private investors currently issue international bonds denominated in ECUs.

[6] The new ECU will also replace the current basket ECU.

[7] Bundesbank President Poehl is chairman of the Committee of Central Bank Governors, which drafted the statute of the ESCB. The Committee consists of the governors of the central banks of each of the 12 member-countries.

[8] These bodies are similar to the Directorate, the Land Central Banks, and the Central Bank Council of the Bundesbank and to a lesser extent, the Board of Governors, the Federal Reserve Banks, and the Federal Open Market Committee of the Federal Reserve System.

[9] The Council of the ESCB should not be confused with the European Council. The European Council is an existing Community organization, consisting of representatives of each EC nation. The European Council will appoint the six members of the Executive Board.

[10] Margaret Thatcher was particularly critical of the loss of national sovereignty implied by the Delors Report. Her bitter opposition to EMU contributed to her resignation as U.K. prime minister.

[11] Germany also supports a slower approach to EMU because it is currently preoccupied with its own reunification problems (Riding).

[12] The Delors Report states that large regional differences "would pose an economic as well as political threat to the union."

[13] Not everyone in the United Kingdom opposes the two-tier plan. Some believe a two-speed system might reduce pressure on the United Kingdom to join a complete economic and monetary union (Buchan).

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