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M. Camdessus, Chairman

Executive Directors	Alternate Executive Directors
M. Al-Jasser	
M. Autheman	
	E. Srejber
H. Evans	
	T. Fukuyama
	L. E. N. Fernando
J. E. Ismael	K.-T. Hetrakul
	R. Ferrillo, Temporary
	M. C. B. Arreas, Temporary
	C. Y. Glazkov, Temporary
W. Kiekens	
G. Lanciotti	
K. Lissakers	
	P. A. Merino, Temporary
	M. Daïri
	J. A. K. Munthali, Temporary
G. A. Posthumus	
	N. Toé, Temporary
S. Schoenberg	
A. S. Shaalan	Y. Y. Mohammed
D. E. Smee	
E. L. Waterman	
	Wei B.
	J. A. Costa, Temporary

L. Van Houtven, Secretary and Counsellor
S. Yeager, Assistant

Also Present

European I Department: J. R. Artus, Deputy Director; S. G. B. Henry, D. C. McDonald, S. Oberg. External Relations Department: S. J. Anjaria, Director. Fiscal Affairs Department: A. A. Tait, Deputy Director; E. T. DeCallatay. Policy Development and Review Department: J. T. Boorman, Director; F. C. Adams, M. Allen, R. T. Harmsen, N. Kirmani, J. F. van Houten. Research Department: M. Mussa, Economic Counsellor and Director; D. M. Laxton. Secretary's Department: A. Leipold, A. Mountford. Treasurer's Department: K. A-M. Westin. Office of the Managing Director: G. R. Saunders, Personal Assistant. Advisors to Executive Directors: G. M. Blome, P. Cailleteau, T. K. Gaspard, J. M. Jones, R. Kannan, A. Törnqvist, J. W. van der Kaaij. Assistants to Executive Directors: S. Al-Huseini, S. Arifin, R. D. Bessone Basto, G. El-Masry, O. Himani, E. Kouprianova, K. J. Langdon, F. Moss, S. Narube, R. K. W. Powell, V. Verjbitski, S. Vori.

1. EUROPEAN UNION - COMMON POLICIES AND RECENT INSTITUTIONAL DEVELOPMENTS

The Executive Directors considered a staff paper on common policies and recent institutional developments of the European Union (EU)(SM/94/120, 5/12/94; Sup. 1, 5/18/94; and Sup. 1, Cor. 1, 5/18/94).

The Deputy Director of the European I Department said that the Commission had finalized a proposed new set of policy guidelines, which were being discussed by the Council of Finance Ministers that day. Revised guidelines would be submitted to a meeting of the European Council later in the month.

The new proposal was more detailed and more country specific than that of December 1993, the Deputy Director of the European I Department observed. In the area of public finances, the Commission had stressed a need to confirm in the 1995 budget that fiscal consolidation was under way and had identified in broad terms the budgetary challenge in each of seven countries. It had also identified those countries where improvements in tax administration were warranted and others where pressure on current expenditures needed to be contained. In addition, the Commission had identified explicitly countries that, on current projections, would not have reduced inflation to the range of 2 percent to 3 percent by 1995. In the area of labor policy, countries that planned to introduce measures to lower nonwage labor costs and take other steps to encourage employment had been identified.

Mr. Shaalan made the following statement:

We welcome this opportunity to review common policies and recent institutional developments in the European Union. Clearly, there has been a marked increase in recent years in the attention paid to policy interaction within the European Community. Moreover, EU institutions have been assigned a key role in policy coordination and surveillance in areas of concern to the Fund in this important region. These considerations make regular formal contacts and discussions between the Fund and the institutions in question a virtual necessity. In our view, such contacts and discussions, which constitute a vital link in the ongoing effort to enhance the regional focus of Fund surveillance, serve to impart a global perspective to the process of policy coordination within the EU. They also serve to enhance the relevance and effectiveness of Fund surveillance over the policies of individual members within the Union.

Viewed from this perspective, the multilateral surveillance of EU institutions and that of the Fund can only complement one another and would thus tend to be mutually reinforcing. The two types of surveillance activities have much in common, including that their effectiveness ultimately depends on the willingness of members to take appropriate policy decisions. In-depth analysis of the policy interaction among members and of the feedbacks and spillover effects of domestic policy choices do have an important role to play in highlighting to the individual members the benefits of pursuing policies that are judged appropriate from regional and global perspectives. This enhances the acceptability of EU policy advice given to individual members in the context of the surveillance exercise. Beyond this, the effectiveness of surveillance stands to gain from the potential threat of excluding from the European economic and monetary union those members that fail to follow sufficiently prudent macroeconomic policies. The possibility of publication by the Council of Ministers of its recommendations vis-à-vis member countries could also serve as a disciplining instrument. The effectiveness of the latter instrument may be tempered, however, by the fact that it requires a qualified majority as well as by the "strategic considerations" mentioned on page 7 of the staff paper. In any event, the high degree of complementarity between Fund surveillance and EU surveillance implies that the effectiveness of Fund surveillance stands to benefit from whatever elements of discipline EU surveillance may possess.

I am in broad agreement with the views set out in the staff paper. I believe that the staff's views are particularly pertinent with respect to labor market reform, the common agricultural policy (CAP), access to EU markets for producers outside, as well as within, the Union and the possible need for a tightening of policies on subsidies. As regards tax harmonization, I note the difficulties that have so far hampered the effort in this area. In this connection, I would stress the potential risk that may be entailed by failure to agree on a common policy in sectors with relatively high factor mobility, such as financial services; namely, the risk of upward pressure on the tax structure in the other sectors that could be precipitated by tax competition in sectors with relatively high factor mobility. This could add significantly to the distortions associated with the already heavy tax burden in other sectors, including trade-sensitive sectors.

Third-country issues could have received broader coverage in the staff paper. It is true that the staff has devoted some attention to third countries in Europe. It is also true that a global perspective underlay much of the staff's discussions with Commission staff. Nevertheless, I believe that issues related to the interaction between the European Union and countries outside Europe should have been explicitly covered in the main paper, and I hope this will be taken into account in future discussions with the Union.

Mr. Lanciotti made the following statement:

As head of the constituency representing Greece, the country currently holding the presidency of the European Union, and in agreement with my other EU colleagues, I would like to say a few words on the document before us today. In my remarks, I will deliberately not touch upon the "issues for discussion."

The staff is to be commended for the informative and articulate paper, which provides a broad and clear synthesis of recent developments in the institutions and common policies of the European Union, reviewing, in particular, progress in the internal market program and advancements in the activity of policy coordination and surveillance linked to the enactment of the Maastricht Treaty, which entered into force in January 1994. Considering these important accomplishments within the Union, I cannot help having a feeling of pride in what has been achieved at the Union level, especially when considering the large variety of diverse cultural and economic national identities that had to be accommodated in a single project of political and economic union. At a time when issues of regional integration are being widely debated, the experience of the European Union provides a reference that other countries might find useful when developing their own paradigm of integration.

I have only a few general remarks on the staff analysis. First, I note that the document fails to report, even indirectly, on the work carried out at the national level in order to fulfill the obligations deriving from the Maastricht Treaty. Thus, a wide and complex effort of institutional revision has been disregarded; this effort has led to important reforms aimed at establishing the independence of the central bank and at excluding monetary financing of public deficits and privileged access to financial institutions. In general, the relationship between central banks and public governments appears appropriately changed in the direction indicated by the Maastricht Treaty. This is proof that the guidelines contained in the Treaty are already producing important results: therefore, those who advised that "the Maastricht Treaty was stillborn" were wrong.

Second, I deem excessively synthetic the treatment of the issues that are being addressed in the past and present stage of transition to economic and monetary union (EMU). In particular, the document fails to mention the important bulk of work already developed within the Committee of Governors. The work of this Committee, and of the several subcommittees under its surveillance, concerning important issues in the field of monetary and exchange policy instruments, banking supervision, payment systems, and statistics and accounting, provides the necessary background to ensure that the European Monetary Institute will be on a firm footing at the start of its operations.

The staff recalls that "monetary arrangements within the EU differ markedly from what was envisaged by those who drafted the Treaty." Undoubtedly, the decision to widen the fluctuation bands in the exchange rate mechanism (ERM) and the suspension of the participation of the United Kingdom and Italy deprive the coordination of monetary policies within the Union of important terms of reference. However, the European project has emerged from recent events with new strength, which has proved the validity of an approach to European integration based on the development of free and competitive markets, the convergence of economic fundamentals, and the strengthening of monetary coordination within the framework of common European institutions.

In conclusion, the European project represents a guarantee of development and stability for both the countries belonging to the European Union and those outside its borders. The current outlook for a recovery of economic activity in Europe will offer new opportunities to EU members to address effectively structural weaknesses, particularly unemployment and public finances. The extension of membership to other European countries and the eventual full integration of Central and Eastern European economies in transition represents, in perspective, a formidable challenge to be faced.

Mr. Ismael made the following statement:

Coordination, surveillance, and integration are central to the achievement of the European Union's objectives of promoting economic and social progress among its members, asserting its identity on the international scene, and developing cooperation in home and justice affairs. The Maastrict Treaty not only spells out these goals but also the form of cooperation by which such goals will be pursued, some by member states and some by the Union. The Union's most important goal is the establishment of European economic and monetary union under a specific timetable and preassigned economic conditions.

The move to the EMU is supposedly in its second stage with the establishment of the European Monetary Institute. Although there is some convergence on the inflation front, compliance with the debt and the fiscal deficit levels under the Treaty will be extremely difficult. While there is political will to keep to the EMU program, reality will ultimately dictate a more realistic timetable.

Convergence has also come at a difficult cyclical time when economic conditions warrant some preoccupation with domestic problems. This policy dilemma will be the major challenge to the road to EMU. Understandably, something must be done to alleviate unemployment. The Delors's white paper entitled "Growth, Competitiveness and Employment" recommends an enormous spending program by the Union on trans-Europe infrastructure. Financing this program will certainly make fiscal consolidation much difficult for member states. Many member states should confront the real culprits of structural unemployment, namely, the rigid labor market, the large social security burden, and the high wage rate. Politically, these are sensitive areas and progress is invariably slow and difficult. But efforts must continue on these fronts. Aspiring to the guidelines of the Treaty is not inconsistent with a longer-term solution to unemployment. The most efficient solution is a cooperative one, keeping in mind that the process will take time.

On monetary policy, it is too early to assess the effectiveness of the Institute. The Institute has a challenging agenda, and its role will be crucial to the program of convergence and to the establishment of the monetary union. At this embryonic stage, the focus of surveillance is primarily on monitoring the implementation of policies for convergence and not so much on convergence per se. Hence, I would expect the Institute to exercise considerable flexibility in its surveillance and its choice of indicators. The instruments of and institutional arrangement for surveillance appear adequate and the remedy sufficient.

The interaction of multilateral surveillance is important for consistency, transparency, and coordination. There will be overlapping areas between the global nature of the Fund's surveillance and the regional role of the Institute. I expect that many of these areas will be complementary to both institutions, and a systematic channel of contact is obviously essential. In areas where there may be differences, an informal resolution framework can be useful. More important, the Fund needs to be proactive in minimizing the spillover of adverse developments in the EMU.

Market integration is critical to extracting the full economic advantages of the Treaty. It is conflict at the microeconomic level that poses the greatest risk to the Union. The critical issue of subsidiarity, therefore, needs to be firmly set and more clearly defined. Here, a pragmatic approach may bring more success. In agriculture, while moving domestic prices closer to world prices will enhance competition and productivity, a pragmatic solution could be to set a modest ceiling on the degree of protection and allow reciprocal bilateral arrangements among members below this minimum.

The integration of transition economies into the Union should be a medium-term goal. Stability is the cornerstone of the long-term vitality of the Union. However, with the safeguard mechanism under the GATT framework as a backup, dismantling the Union's barriers to trade with economies in the east should reap considerable mutual benefits.

Mr. Schoenberg said that he welcomed the staff's comprehensive and, on the whole, well-balanced analysis of recent institutional and economic policy developments in the European Union. He wished, first, to comment on the so-called guidelines for economic policies of member states and of the Community, even though those guidelines were currently being revised.

The staff pointed out that the guidelines appeared to be broadly suited to the current economic situation, and that the recommendations on fiscal consolidation, in particular, were similar to the position taken by the staff in Article IV discussions and in the context of the world economic outlook, Mr. Schoenberg observed. The guidelines underlined, in particular, that each EU country must make the necessary efforts to attain the Maastricht criteria concerning budgetary deficits and public debt within a reasonable period of time. Germany would soon assume the EU presidency and would see to it that during its tenure a new dynamism toward attainment of the Maastricht criteria would be set into motion. His authorities considered that to be especially important as attempts to weaken or circumvent the Maastricht criteria or to unduly delay the fiscal consolidation process would increase the existing skepticism about EMU in Germany and elsewhere and would thus endanger the whole concept.

One option proposed by Mr. Ismael was a less ambitious timetable for EMU, Mr. Schoenbery continued. The other was to operate with the concept of different integration speeds and to start with only a certain number of countries satisfying the Maastricht criteria. Perhaps, in practice, both parameters would be used.

The staff had also observed that the guidelines focused, to a large extent, on medium-term issues, Mr. Schoenberg commented. That medium-term emphasis was appropriate and justified, in his view, because most economic problems of EU countries are deep rooted and complex in nature and would take time before being overcome.

The staff also appeared to hold the view that the guidelines gave too little attention to the specific policy needs of individual member states, Mr. Schoenberg observed. He shared that view to a certain extent. One had to keep in mind, however, that the main task of the guidelines was to provide a general framework for economic policies of member states, while the concrete economic performance of each individual country in each policy area would be discussed and monitored within other mechanisms and procedures. There were, for example, special periodic reviews of budgetary developments in the Community.

On labor market issues, he agreed with the view that the main reason for the relatively high unemployment rates in Europe lay in structural rigidities in the labor market and, more generally, in the whole economy, Mr. Schoenberg stated. Against that background, the question arose whether the current EU employment strategy puts sufficient emphasis on labor market deregulation and welfare reform. In his view, the staff had a strong point in suggesting that there was a need for a more comprehensive concept that should, in particular, include a review of welfare benefits, which provided the wrong incentives and which became increasingly difficult to finance, and of the system of minimum wages. In addition, further efforts might be necessary to improve the competitiveness of Europe's economy and to remove impediments to growth, inter alia, by abolishing sector-specific protection measures.

There were some convincing reservations against the idea of allowing tax incentives for employment of lower-paid workers, Mr. Schoenberg observed. Such state interventions in the labor market risked further complicating rather than simplifying labor market regulations. In view of the weaknesses in the current EU employment strategy, he hoped that a further strengthening of the strategy could be achieved in the ongoing discussions on the subject. At the same time, it would be stressed that the EU's labor market strategy contained a number of important actions, including measures aimed at wage moderation and improving education and skills, which were noteworthy. The strategy thus provided a reasonable starting point for a common EU labor market policy.

As for the role of the European Monetary Institute, the staff had rightly pointed out that the major task of the institution was to strengthen monetary cooperation and coordination, while the conduct of monetary policy would remain the responsibility of national central banks during Stage II of EMU, Mr. Schoenberg continued. From the German point of view, it was important that those different responsibilities were respected. The Institute could, of course, influence monetary policies of EU members to some extent through its analysis and recommendations. Its activity might thus have positive impacts on the performance of prices and exchange rates.

Concerning the latter, the widening of the ERM bands in August 1993 had obviously proved correct, Mr. Schoenberg stated. It was remarkable that no member of the EMS core had used the newly gained room for maneuver for an undue relaxation of monetary policy and that a number of EMS currencies had re-entered or at least re-approached the former narrow bands. That underlined the unbroken commitment of EMS members to exchange rate stability, and the convergence process in Europe would be further supported by the implementation of the announced fiscal consolidation measures and structural reforms in EU member countries. Therefore, the road to EMU as outlined in the Maastricht Treaty remained realistic in his authorities' view.

Regarding Fund surveillance over the evolving European Union, current procedures should be continued, Mr. Schoenberg considered. There was no need to increase the Fund's surveillance further at the current stage. After the EMU had been established, the Fund might, however, consider preparing once a year a kind of Article IV consultation report for the EC as a whole, with particular reference to the common monetary policy and the external balance of payments.

Concerning the contentious agricultural policy of the EU, there appeared to be broad agreement that further comprehensive reforms would be needed to reduce surplus production and the degree of protection, Mr. Schoenberg stated. Farmers should be supported by tax incentives or direct income assistance rather than by nonmarket-related prices for their products, which would allow the EU to move the level of agriculture prices closer to current world market levels. It was encouraging that the EU had already taken some important steps in that direction and that additional efforts were currently being discussed.

On relations with Central and Eastern European countries in transition, he wished to underline the argumentation of the European Commission that the pace of trade liberalization for most industrial products had been impressive and that the remaining restrictions in the areas of steel, clothing, and textiles were going to be phased out within a reasonable period of time, Mr. Schoenberg commented. It was noteworthy in that regard that the timetable for the elimination of tariffs and quotas on textiles and clothing entailed a pace that was more than twice as fast as that under the Uruguay agreement. In addition, the access of the transition countries to the European agricultural market would also be improved. Account should also be taken of the EU's substantial financial and technical assistance to those countries--a point that had not been explicitly mentioned in the staff paper. It could be argued that, on the whole, EU support of the transition countries was substantial.

He did not believe that there was a conflict between fiscal consolidation and the requirement of additionality that was the national contribution to the funding of projects supported by the EU structural funds, Mr. Schoenberg remarked. The Maastricht criteria had set upper limits for fiscal imbalances in all EU members, and the recipients of assistance from the structural fund too were obliged to orient their overall fiscal policy to those criteria. If an increase in public investment expenditures became necessary in one country because of the requirements of additionality, the country concerned would have to finance that increase by savings in other areas in order to avoid a deterioration of the overall fiscal balance. It should also be noted that the public investment expenditure would spur economic activity, and thereby public revenues, which would make the fiscal consolidation process easier. At the same time, it was easy to overlook the fact--indeed, there was no reference in the staff paper--that the refinancing of the increased structural funds and of other community expenses burdened heavily the budgets of the net contributors--and, above all, Germany's budget. Germany's net contribution to the EU might reach a magnitude of about DM 30 billion in 1994, which was equivalent to nearly one half Germany's 1994 federal budget deficit. Although that problem must primarily be discussed within the EU institutions, the staff paper might have mentioned the increasing discrepancy between Germany's paymaster role in the EU and the EU average per capita GDP after unification; under the current mechanism, Germany was in fact subsidizing wealthier EU countries.

The Chairman said that in view of Germany's heavy contribution to the EU budget, he would be interested in Mr. Schoenberg's reaction to the remark of the Chairman of the German Chamber of Commerce that Germany should not complain about its contribution to the EU budget, as Germany on the whole benefited more from Common Market and EU developments.

Mr. Schoenberg remarked that a quantification of the overall benefits and burdens deriving from EU membership was difficult in any instance. How, for example, would one quantify the political benefits, which were immeasurable? His remark on Germany's contribution and its impact on the German budget was intended primarily to counter the recent heavy criticism of budgetary developments in Germany.

Mr. Evans made the following statement:

> A number of institutions are now involved in surveillance of macroeconomic developments in EU countries. Apart from the Fund and the OECD, there is the European Union's Monetary Committee and ECOFIN, and now the European Monetary Institute. The new Institute clearly has a valuable role to play in promoting greater coordination of economic and monetary policies between EU member states. We look for close cooperation between the Institute and the Fund. I believe that both institutions have valuable roles to play. We want the advice of institutions outside, as well as inside, the Union. More effective multilateral surveillance should help to promote economic convergence. But we firmly believe that while the pursuit of price stability should be the basis of all our monetary policies within the Union, it remains, as Mr. Schoenberg reminds us, for national authorities to pursue that goal by following the policies best-suited to their own domestic conditions. It is economic convergence rather than any institutional framework that is more relevant for exchange rate stability. Moreover, it is important to remember that the Fund has no direct relationship with the European Union or with the Commission. For the benefit of those not familiar with EU institutions, it should be clear that the expressed views of the Commission are not necessarily the views of the EU member states individually or even jointly in the form of the Council of Ministers.
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> Real economic convergence is a necessary but not sufficient condition for economic and monetary union to take place. The staff is right to note that policymakers have become increasingly concerned by structural problems, especially those in the labor

markets. I fully expect the United Kingdom to meet all the macroeconomic Maastricht criteria on time. There remains the question of whether we would decide to join a single currency: the United Kingdom has not committed itself to joining a Monetary Union. It is evident that there are different views within the United Kingdom: that is not surprising, in view of the fact that a decision to join by the United Kingdom before the next general election is inconceivable.

The staff asks for comments on the strategy outlined in the Commission White Paper, which emphasizes fiscal consolidation, wage moderation, and active labor market measures. Wage moderation is relevant, but it also important to minimize nonwage labor costs and regulation, not only because it tends to impede flexibility but also because it tends to exclude certain groups; for example, restrictions on part-time work tend to have a disproportionate effect on women. I share the skepticism expressed by staff on this matter.

The Chairman observed that potentially, there would be four groups of countries in the EEC: those meeting the Maastrict criteria but not joining the monetary union; those wanting to join but not meeting the criteria; those joining and having fulfilled the criteria; and those joining because they showed a good trend toward meeting the criteria.

Mr. Fukuyama made the following statement:

On the points raised in the staff paper, I note that the guidelines for surveillance, while being nonspecific in general, make a distinction between countries with critical fiscal situations and others. As the staff argues, this approach is realistic in balancing the need for fiscal consolidation and the concern to avoid weakening the economic recovery. It is also appropriate and is in line with the argument within the Fund that even for countries in a less critical situation, the guidelines call for an early announcement of consolidation measures to take effect as recovery takes hold.

If the expected economic recovery in Europe proves sustainable, it is anticipated that many countries--I am hesitant to say "most" countries--can attain the criterion for the general government deficit of 3 percent of GDP by 1996. In addition, the guidelines include the recommendation of a fiscal position close to balance by the year 2000. It is surely difficult to attain this objective, judging from historical experience. However, I hope that the guidelines effectively stimulate momentum toward further fiscal consolidation beyond 1996.

As to labor market policies, I agree with the staff's views. It is certainly doubtful whether the strategy described in the

White Paper will bring about the expected reduction in the unemployment rate. In my view, the basic issue facing the European labor market is how to improve incentives to work. Therefore, it is necessary to implement such measures to encourage and help the unemployed to seek work.

As described in the staff paper, the European Monetary Institute has three major tasks, all of which are important. However, I have the impression that, in reality, the Institute may have to allocate a major part of its efforts in preparation for the future European Central Bank. Many issues that are fundamental for the operations of the bank are difficult to solve, such as the role of mandatory reserve requirements and the selection of intermediate targets.

Fortunately, inflation has generally calmed down, and recently, exchange rates are relatively stable. Nonetheless, there is no assurance that such a situation will last for a long time. Moreover, whatever is stipulated in the Treaty, the replacement of the Institute by the European Central Bank will be preceded by a transitional period during which the Institute will gradually assume the character of a central bank. Therefore, it will be necessary, sooner or later, to examine the possible strengthening of the functions of the European Monetary Institute in relation to the surveillance of monetary policies in member countries.

It is possible that the Union's surveillance, which will naturally put emphasis on European integration, will conflict with the Fund's surveillance, which is exercised from a more global perspective. This possibility is cause for concern and should be avoided as much as possible by, for example, frequent informal exchanges of views between the two institutions.

We note that the EU has taken steady steps toward market integration. The liberalization of internal markets has progressed considerably, and even in agriculture, where reform is particularly difficult for political reasons, a shift, although partially, from price support to direct income support was realized. The positive opening of EU markets to Central and Eastern European countries has certainly contributed to the smooth transition of these countries to market economy.

At the same time, I realize that difficulties will increase as the move to economic and monetary union proceeds. Solving the remaining issues mentioned in the staff paper will usually be accompanied by political pain. Therefore, an important issue is how to avoid losing momentum. In this respect, the Fund may be able to play a certain role by presenting its views and, thus, stimulating discussion in this area.

Mr. Evans observed that Mr. Fukuyama had referred to the gradual assumption by the European Monetary Institute of responsibilities of a central bank. Such a change could not be effected gradually, nor could the assumption of monetary responsibilities. Such responsibilities either had to rest with national authorities or they had to rest with the European central bank, and it would not be easy to find an intermediate, gradually shifting, position.

Mr. Schoenberg said that he agreed with Mr. Evans. At every point, it must be clear who was in charge. Moreover, the Institute had a great deal to do to prepare the work of a European central bank, including taking decisions on the instruments to be used, the objectives to be followed, and the statistics to be harmonized.

Mr. Fukuyama remarked that he understood that during Stage II, individual central banks had responsibility for individual member's monetary policies. At the same time, however, the Institute had to prepare for the day when it assumed the role of a central bank.

Ms. Lissakers, reflecting on the issues of a transition period and the need to centralize responsibilities in a single central bank, observed that the history of the U.S. monetary system showed that it was possible to have one currency and shared responsibility for the central banking system. Until the 1950s, for example, regional Federal Reserve banks set their own discount rate, so that they, in fact, were responsible for regional monetary policy. Thus, it was possible to have as single currency with central banking responsibilities shared on a regional basis.

Mr. Waterman said that the discussion so far raised an interesting point, namely, for purposes of regional surveillance, to whom was the Fund directing its comments--the European Council, the European Monetary Institute, or the collective governments?

Mr. Lanciotti remarked that it was true that in Stage II the responsibility for monetary policy rested with the national authorities. But, while the objective was to strengthen cooperation and coordination among the monetary policies of individual member states, the institutional preconditions were in place to enable the European Monetary Institute to significantly strengthen cooperation among national authorities in the area of monetary policy. Monetary coordination exercises were, in fact, currently being pursued and would continue.

Mr. Merino observed that because the differences among EU countries in terms of regulations as well as the degree of integration of financial markets, the possibility of having one currency with regional central banks sharing responsibility for monetary policy appeared to be impractical if not impossible for Europe.

As to the timing of the establishment of a central bank for Europe, the only problem was political will, Mr. Merino stated. If there was a political will, all other problems, such as coordination of statistics, would pose no difficulties.

Mr. Kiekens said that he did not believe that a monetary union with one single currency and different central banks sharing responsibility for monetary policy was possible when financial markets were integrated, as in the EU. In an integrated financial market, the establishment of different discount rates by different central banks would mean that the central bank with the lowest interest rate would be subsidizing banks having access to its resources.

The Chairman recalled that Mr. Fukuyama had alluded to a possible useful role of the Fund, particularly during the time of transition to Phase III. In particular, he had mentioned a possible conflict between the approaches to surveillance of the European Monetary Institute and the Fund and had suggested increased informal contacts to narrow the scope for divergent advice between the two institutions. He would be interested in further elaboration on a possible role of the Fund in that context.

Mr. Fukuyama remarked that as the two institutions would be conducting surveillance from a different point of view, there might be some conflict. He would therefore like to see emphasis placed on frequent contacts between Fund staff and EU organs to ensure that sufficient consideration was given to the global economy. As EMU proceeded, the process of unification was likely to become more difficult, owing in part to political considerations. In that context, the Fund could play a useful role by ensuring that there was no loss of momentum on account of a lack of discussion of outstanding issues. The Fund staff could, for example, take a global viewpoint in its Article IV consultation discussions with individual countries, including focusing on the further steps that should be taken in the EU context.

Mr. Schoenberg said that, unlike Mr. Fukuyama, he saw less possibility for a conflict between Fund surveillance and EU surveillance. Rather, he saw a hierarchy: Fund surveillance was much stricter than EU surveillance.

Mr. Al-Jasser made the following statement:

> The staff presents a useful survey of recent institutional developments and common policies in the European Union. I will make two broad remarks regarding Fund surveillance before turning to a few specific issues.
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> Recent institutional developments and common policies in the EU have important implications for the membership as a whole. From the global perspective of the Fund, however, I felt that the implications of these developments on economies outside the EU would have warranted a more extensive coverage than the paper provides. For example, no reference is made to Turkey anywhere in the paper, although it is expected to finalize a Customs Union with the EU in the near future.

Surveillance of macroeconomic policies in Europe is two-pronged; namely, surveillance by the Council of Ministers, supported by the Commission, and surveillance by the European Monetary Institute. Surveillance by the Council of Ministers, as the staff points out, is undertaken by governmental organizations. Surveillance by the Institute, on the other hand, is designed to be independent, as the Institute is expected to be replaced by a European central bank. These two types of surveillance are complementary. Arguably, the former can be more accommodative of some of the policy constraints facing members. However, neither type of surveillance incorporates the broad global perspective that is offered by the Fund. Indeed, the paper before us serves to highlight the importance of the attention to regional developments that the Interim Committee endorsed in its April 1993 declaration.

As I agree with many of the staff's views, I will make only three comments regarding some specific policy issues raised in the paper.

The analysis of macroeconomic policies presented by the staff confirms much of the conclusions of our last world economic outlook discussion as well as the Article IV consultations with individual member states. I share the views of the staff that the EU-wide goal of fiscal consolidation based on the Maastricht Treaty provides an appropriate balance between the need for consolidation and the concern to avoid weakening the economic recovery. The focus must now be on implementation. The Maastricht Treaty does not provide for sanctions to be applied in the case of "excessive deficits." Thus, the full responsibility for the success of the Treaty falls on each individual country. The staff seems to suggest that countries with critical fiscal positions must implement strong measures to correct the imbalances in 1994, while the focus on a medium-term framework by countries with more room for maneuver is a satisfactory start. However, it can be argued that, as the responsibility for adherence to the convergence path lies with each individual country, it is important for each country to set an example as early as possible.

With respect to the labor market, the staff presents a very useful critique of the current EU policy guidelines. In particular, there is a clear need for a broader range of measures to address the adverse incentives resulting from minimum wage and other regulations as well as overly-generous welfare benefits. The direct role of the EU in labor market policies of individual members is limited. Nevertheless, policies in this area have direct implications in areas where the EU does have an important role. Agreement on broad common principles may make it easier for individual countries to implement policies. The recent attention paid to the labor market is therefore a welcome first step.

The staff paper highlights the important achievements in market integration. Indeed, the increased emphasis on competition has deepened the internal market. The staff highlights two sectors where progress lags or is completely stalled, namely, the agricultural and energy sectors. The rigidities and distortions that persist in both sectors give rise to inefficiencies of a large magnitude, in addition to budgetary costs. Furthermore, there is a risk that without further progress in reforming the CAP, some possible future members of the EU will need to adopt distortive agricultural policies upon EU membership. Early progress in these areas will allow EU members to reap the benefits of trade, while reducing the budgetary costs of current policies.

The Chairman said that it was remarkable that despite the proliferation of new institutions with a surveillance role, not one of them provided the global perspective of the Fund's surveillance. In those circumstances, the Fund's role could be to help the new institutions in discharging their own responsibilities. But that role would have to be clear and discussed with each institution in the light of its own mandate.

Mr. Al-Jasser remarked that he agreed with the Chairman. If, as Mr. Schoenberg had suggested, Fund surveillance was perceived to be much stronger than EU surveillance, a moral hazard would arise--namely, of circumventing that stronger surveillance by some other arrangement.

Mr. Posthumus made the following statement:

I warmly welcome the staff paper on common policies and recent institutional developments in the EU, which is very informative, and not only for non-EU Directors.

I will concentrate on the issues raised in the first part of the paper, namely, "coordination and surveillance of macroeconomic policies," which also includes a paragraph on the White Paper on "Growth, Competitiveness and Employment." These are the subjects that are closest to the mandate of the Fund and on which the Fund should keep an eye.

On the broad economic guidelines, and in particular on the recommendations concerning fiscal consolidation, the staff rightly points out that the effectiveness of the guidelines will ultimately depend on the willingness of members to take the appropriate policy decisions. There is a basic question here, that is, whether in EMU a centralized monetary policy and a decentralized budgetary policy will be sustainable. The staff does not really address this issue. This is regrettable as it would offer the Fund staff an opportunity to shed light on a topic that is at present being debated in a European context, namely, whether the economic pillar of the EMU is sufficiently developed to ensure stability. In general, I would suggest that this Board, in accordance with its task of monitoring important regional developments, pay attention to issues still under discussion within the EU.

On the position of the European Monetary Institute, contrary to what the staff seems to suggest on page 29, I feel that the Institute has a clear mandate with regard to surveillance. Obviously, what matters is whether this mandate will be put into practice. For this, the Treaty provides several instruments; in particular it stipulates that the Institute may formulate opinions or recommendations on monetary and exchange rate policies and on policies that might affect the internal or external monetary situation in the Community. In this respect, it can be said that the Institute already criticized developments in EC public finances at the Informal ECOFIN meeting last April. Furthermore, the Institute will give an opinion on fiscal trends in the member states in the forthcoming ECOFIN, with a view to the excessive deficit procedure. The staff questions whether the surveillance role of the Institute will provide sufficient institutional support for inflation convergence in the EMU as well as an adequate bulwark against the re-emergence of tensions in European foreign exchange markets. In itself, it does not. It is necessary for the national central banks--and the Institute is not a central bank--that the governments as well as employers and employees play their part in achieving price stability. The Treaty does provide some useful instruments, including the excessive deficit procedure, to encourage this, but also stipulates that only countries that fulfil the convergence criteria can enter the third stage of EMU. Thus, if a country wants to participate, it should put its own house in order.

Regarding the strategy to reduce unemployment, I share the staff's doubts on whether the menu of policy options proposed in the White Paper will be adequate to restore growth and competitiveness in the European Union. Considering that the share of labor income in the Community has been going up since 1990, the Netherland's authorities believe that a moderation of wages should remain an important ingredient in the proposed menu of the White Paper.

Mr. Ismael said that, following on Mr. Posthumus's remarks, the Fund could take a proactive stance through closer surveillance and prior monitoring--for example, through regular attention by the staff and the Board to issues and developments in the European Union--and, perhaps, through consideration of a more practical framework. For example, a stabilization fund for exchange rate variations could be created.

Mr. Wei made the following statement:

We generally share the staff view's that, taking the broad EU perspective, its strategy toward an economic and monetary union appropriately emphasizes the balance between making progress on consolidation and concern to avoid weakening the economic recovery. However, there are some uncertainties regarding the effectiveness of financial policy coordination and the role of institutional support.

With regard to the objective of achieving EMU, effective macroeconomic policy coordination and the role of institutional support will depend not only on the success of achieving a real and substantial degree of macroeconomic convergence, but also on ensuring that national policies are made consistently with a view to preparing for the operation of a single monetary policy. To enhance the prospects for EMU, more action is required, including political willingness with regard to financial policy cooperation and surveillance, and structural reforms, particularly labor market reform.

On financial policy cooperation and surveillance, we see wide recognition of the urgent need for fiscal consolidation and general progress in this area. In this respect, the importance for EU members to achieve the fiscal targets in terms of the government deficit/GDP ratio cannot be overemphasized.

While we are pleased to note that most countries will be able to satisfy the Maastricht deficit criterion of 3 percent in 1996, we are concerned about how countries with excessive deficits can achieve the target. On this issue, we think that the Union has taken a realistic approach, as declared in the EU economic guidelines, in making a distinction between countries with critical fiscal situations and other countries. Although we believe that further progress on fiscal consolidation is important and that this further advance is closely linked with labor market reform, in our view, too many front-loaded fiscal measures will jeopardize the economic recovery in these countries. Therefore, we support the EU's pragmatic approach even if it takes longer than scheduled for these countries to achieve the target.

Concerning the newly established European Monetary Institute, I share the staff's views. However, I would like to raise a question.

On fiscal policy, concrete policies and criteria have been established in terms of the 3 percent fiscal deficit/GNP ratio to be achieved in 1996 and even some sanction measures are being formulated for those countries that cannot meet the target. However, looking at monetary policy, it is most probable that the

EMU's scheduled Stage II target will have to be postponed, as some countries are still outside the pegging arrangement. We do not know when the expanded band will be narrowed to its previous limit. More important, there is no firm agenda to address these issues. Therefore, we foresee an uneven development for fiscal and monetary policy in terms of convergence. Unless some effective policies are taken to address this issue, the process of EMU will probably be extended. Staff comment on this point would be appreciated.

On structural issues, we believe that structural reform, particularly labor market reform, is critical to an efficient internal market. European countries should make further efforts to reduce labor market regulations and lower barriers to cheap imports so as to increase competitiveness with the aim of reducing unemployment, which has been widespread and persistent in most EU countries. There is increasing recognition of labor market rigidities, and the measures taken by the national authorities are welcome. However, owing to the seriousness of this issue, both national authorities and the EU institutions must persevere with implementing those measures. Otherwise, the unemployment issue cannot be solved in a fundamental way.

Although the Union is still in its formative stage, it would be helpful for the Fund, while adhering to its traditional practices with regard to member countries, to strengthen its surveillance over EU activities from a global perspective. To prevent the re-emergence of tensions in European currency markets, the Fund should enhance its surveillance to ensure that exchange rate movements are in line with economic fundamentals so as to promote currency stability. To fulfill its mandate of facilitating the expansion and balanced growth of international trade, the Fund should exercise its surveillance in such a way as to promote an EU that is more open to the rest of the world. In this context, the intended policies and measures to promote internal market integration are welcome. However, much remains to be done, particularly in agriculture, among other sectors. Subsidies and restrictions on developing country imports still exist. In this sense, I share Mr. Shaalan's view that it would be useful if issues related to the interaction between the European Union and countries outside Europe could be included in future staff papers.

To conclude, there is still a long way to go economically toward a European Union. Bearing in mind the lessons of the ERM crisis, the Fund should strengthen its current surveillance from a global perspective and explore more efficient ways to enhance its surveillance of regional developments.

Mr. Ferrillo made the following statement:

The recommendations contained in the guidelines of the Council of Ministers are well suited to the current state of the European economy. Fiscal consolidation is essential both for strengthening confidence in policymakers and for providing scope for future investment.

There is a need to reduce fiscal deficits in most European countries, and the present average deficit is certainly unsustainably high. The medium-term strategy to reduce these deficits to less than 1 percent of GDP by the year 2000 seems necessary in the light of the ambitious agenda for integration. However, this target might be difficult to achieve. It might well turn out to be too optimistic, since short-term compromises in respect of ailing business cycles or a sluggish labor market situation are likely to get political preference. Once union is achieved, it will even be more difficult to sustain these short-term arrangements.

The Maastricht convergence criteria provides an intermediary target, and the requirements for building EMU should constitute an incentive for countries to work strenuously toward achieving it, although we doubt whether economic convergence ranks sufficiently high in priority to exert the necessary forceful leverage on policymaking. Achieving these targets implies heavy adjustment efforts for some member countries, and stronger action is required immediately.

The criteria on indebtedness are even more critical to reach by 1996/97, considering the huge debt overhang in many EU countries that failed to reduce their public debt levels during the past economic boom. Today, they face serious constraints.

The EU's strategy to reduce unemployment as laid down in the Commission's White Paper contains some convincing elements and interesting proposals. We are reassured by the commitments of the EU countries both to resist pressures for demand expansion policies and to reject the idea of reintroducing protectionist measures in the face of the social tensions generated by persistent high level of unemployment in Europe.

We fully support the call for fiscal consolidation. Indeed, fiscal consolidation is essential to strengthening confidence and providing scope for the investment that will be needed to sustain the recovery.

Given the globalization of the economy, wage moderation--in terms of both wage and nonwage labor costs--may prove to be necessary. However, we have some doubt about its realism.

Indeed, we are afraid there is no voluntary solidarity between employed and the unemployed workers, between insiders and outsiders. In the circumstances, it would be risky to build a strategy on such a questionable premise. Nevertheless, policymakers can--and should--try to implement wage restraint in the public sector. By the way of pure moral suasion, policymakers may also try to set a wage moderating trend for the private sector. But interference with freedom of association and freedom of collective bargaining by policymakers trying to influence wage determination in the private sector would be problematic.

Under the general heading of active labor market measures, we agree that nonwage labor costs should be reduced so as to increase the employers' incentives to promote net job creation. However, we are not convinced that focusing attention only on low-skilled workers by giving preferential fiscal treatment is the proper way to address unemployment problems in Europe. This would place European countries in a dangerous and already-lost race with developing countries and turn out to be costly for the budget.

In our view, a comprehensive reform of the financing mechanism of social security schemes can better address the true concerns of employers, especially as existing financing mechanisms have excessively penalized the labor factor. In fact, restricting the financing of the social security schemes to labor incomes has increased the relative price of labor and, for the same level of output, has reduced the competitiveness of more labor-intensive production. A new balancing of the system of taxing production factors could at least try to put all factors of production on an equal footing to compete and may restore the principle of neutrality of the fiscal regime.

We would therefore propose to study in depth a broadening of the tax base so as to include all revenues--both from labor and capital--in the financing of social security schemes as well as the redistributive and competitive effects of the reform within the different sectors of the European economy.

Of course, additional measures will inevitably be required to improve the competitiveness of labor. In this regard, we concur with the staff that some possible labor market measures have received too little attention in the White Paper. In particular, we fully support the staff's view that specific measures to increase incentives for job search by reducing the generosity of unemployment benefits--namely, their duration and eligibility requirements--are necessary. Indeed, the OECD's Employment Outlook has demonstrated clearly that unemployment is likely to be high if benefits are available indefinitely, as is the case in most EU countries.

Nevertheless, while seeking to reduce unit labor costs, the redesigning of social security schemes and the correcting of financial imbalances will be needed. But these efforts are unlikely to be sufficient in themselves to properly and comprehensively address the unemployment problem in Europe. This will require additional ideas, and we would like to promote two of them.

First, the mismatch between demand and supply in labor markets, and in particular the higher rate of unemployment among young people, reveals a malfunctioning of the education and vocational training systems. As to vocational training, we would advise the European authorities to promote the idea of a generalized apprenticeship system so as to bring young workers into the labor market and meet the needs of enterprises. Such a system has so far served its purpose well in Germany and Switzerland. Moreover, a reduction of the minimum wage for young workers would be acceptable only in this contractual framework. This system may also serve as a basis for the establishment of continual vocational training for all workers.

Second, some alternative organization of working hours might be worth retaining; for instance, job sharing or reduced hours. These solutions, although partial, should be encouraged, but the conclusion of such arrangements is best done at the company level with the authorities providing, if necessary, some kind of support.

The European Monetary Institute will possibly play a more important role in monetary policy coordination and surveillance than has the Committee of Governors. However, we doubt whether the contribution of the Institute to monetary stability will be as important as the staff implies, as the responsibility for monetary policy will remain in the hands of the national central banks until Stage III is reached.

Unlike the staff, we do not believe that the widening of the bands and the absence of two large countries from the ERM renders the task of the Institute more difficult. The technical preparation of Stage III, which was the main reason for creating the Institute, remains largely unaffected by these facts. The task of the national central banks, however, has become more difficult. The widening of the bands means that the exchange rate target has to be supplemented by another monetary target or by an implicit return to the old narrow bands. Still, large bands have the advantage of allowing for more realistic exchange rates and should provide a strong incentive for better economic policies.

The fact that the Institute is a young institution makes it difficult at this stage to assess the full role that it could play in European monetary policy. Further discussions on the means through which the Institute can and should fulfill its tasks are certainly needed, including within the Fund.

In sum, a conclusion regarding the coordination and surveillance of EU monetary policy and in particular whether the institutional support provided by the Institute for inflation convergence and against the re-emergence of tensions in European foreign exchanges is sufficient is not yet possible.

The conclusion of association agreements with six central and eastern European countries was an important step toward wider continental integration. Trade liberalization is certainly the most effective form of assistance to help these economies grow and develop; it is also the fairest one, as cooperating partners encounter each other on an equal footing, according to their mutual strengths. The objective for trade liberalization to encompass all industrial products by the year 2003 is most welcome, and we hope that this will be amended in the same spirit that led the EU to agree on a more rapid opening of its markets than initially planned.

The dark spot is that the present agreements are the toughest in areas where the partner countries are the most competitive: agriculture, steel, and textiles and clothing. The threat remains that antidumping and safeguard clauses will be imposed as soon as Eastern Europe's competitiveness improves in a specific industrial sector. We would appeal to the EU's evident self-interest to take a more aggressive stance on trade liberalization, as this would, among other positive effects, help to accelerate its own structural adjustment in critical sectors. The possible temporary negative impact on unemployment could be compensated by the earlier-than-planned phasing out of expensive subsidies.

As to the future development of the EU, we welcome the deepening and broadening of the European Union. Since the EU's inception, this process has not always followed a straight line; rather, it has evolved in cycles: major initiatives and enthusiasm has always been followed by ebbs and periods of consolidation. It is possible that such a period is now ahead, after the realization of the internal market and the strong push of monetary integration associated with Maastricht. There is, in my view, nothing wrong, as long as there is no backsliding in the long-term process of integration. As the countries of the European Economic Area gear up for full membership in the EU, we would however plead that the European Union be not strengthened by further delimiting or discriminating against third countries, be they in Europe or beyond. Having said this, I wish the former EEA-countries wholeheartedly that they can join the European Union with the strong endorsement of their populations.

Ms. Lissakers made the following statement:

I believe that it is becoming increasingly important to assess developments in Europe in a regional context. The economic and monetary integration of Europe and the development of a single market is blurring the distinction between national economic policies and requires a common approach on a wide range of issues. In the not-too-distant future, we will need to discuss a European macroeconomic policy in much the same way we now speak of a European monetary and trade policy. In my view, the recent adjustments in the EMS represent an inevitable course correction in the face of an unanticipated storm, rather than a fundamental change in direction. As such, the international community needs to focus more closely on the implications of developments in the European Union, not only for Europe but the world economy in general.

This staff exercise could have been a useful step in this process. But despite its title, the staff paper is heavy on institutional developments and light on common policies and analysis of the larger macroeconomic issues. I would have preferred a more analytical approach akin to an Article IV consultation that could have focused more directly on the economic impact in Europe and for the world economy of the convergence criteria as well as the challenges of expansion. The staff's reticence in commenting on recent monetary developments and how they might affect economic policies and performance in the period leading up to full EMU in 1999 is also striking. Finally, it would have been useful to consider how the EU's economic guidelines and surveillance process might affect the Fund's own surveillance efforts, including whether there are lessons to be learned regarding the use of quantitative indicators and peer pressure exercised through public disclosure. Therefore, we hope that in the future the Fund will undertake regular consultations with the European Commission and members states on EU-wide developments and policies. The Board may also want to consider, in the near future, whether the Fund should undertake Article IV consultations separately with the EU as part of the Fund's surveillance responsibilities.

With these general remarks, I would like to comment briefly on some of the key issues broached by the staff, particularly as they relate to macroeconomic policies.

The economic guidelines adopted to promote convergence under the Maastricht Treaty are crafted understandably with a view to creating the conditions necessary to implement full monetary union by the 1999 objective. However, the achievement of those guidelines will be affected by, and will impact on, economic developments in the near term. The staff has concluded, for example, that the reduction of fiscal deficits to 3 percent of GDP by 1996 can be achieved without seriously weakening demand, although the reasons for this conclusion are not elaborated in any great detail.

Some countries will have a harder task than others, both because their deficits are larger and their economic situations weaker. On balance, however, achievement of the deficit reduction goal will involve the withdrawal of about 3 percent of GDP at a time when economic growth is projected to be about 1 1/2 percent in 1994 and less than 3 percent subsequently. In this context, the staff recognizes that the pace of consolidation will need to vary among countries, with the greatest effort being made by those with the farthest to go. However, it seems to me that inadequate attention has been paid to the impact of deficit cutting by several countries simultaneously rather than one at a time. Consequently, other steps may also be necessary to ensure that the goals of fiscal reform and increased employment do not conflict.

In this context, we were disappointed that the staff did not deal in greater depth with monetary policy. The traditional Fund mantra provides that greater fiscal discipline provides more scope for monetary policy. In the European Union, however, that scope is also constrained by the objective of exchange rate stability. The introduction of wider exchange rate bands and the decision of some EU members to withdraw temporarily from the EMS exchange rate arrangements has facilitated a reduction in European interest rates that will contribute to attaining the fiscal and employment objectives of Maastricht. However, over the longer term the tensions between policy objectives and policy tools will remain. It is not surprising therefore that so much attention has been given in Europe to structural reforms to deal with high and rising long-term unemployment. Nevertheless, it is not clear that structural measures alone can resolve the tension. For example, such reforms cannot respond to shocks such as the unification of Germany or deal with cyclical developments within Europe that may have different effects on countries that are still sovereign nations.

The surveillance and coordination procedures of the European Union and the role of the European Monetary Institute and eventual European central bank will become increasingly important. The role being given to quantitative indicators in this process is striking, particularly as such a procedure has been less than wholly successful in other contexts. Moreover, past experience suggests that reliance on peer pressure appears to be most effective when linked to financial or other constraints. However, such an approach does not have the symmetry of application that might be necessary for the political and economic compromises that will be required.

The need for Europe to improve the functioning of its labor market is by now self-evident, although the means are less clear and will almost certainly vary from country to country. However, with integrated labor, capital, and goods markets, the need for a common approach has increased. The desire to lower wage costs as a means of fostering employment is understandable, although we share the staff's skepticism that fiscal consolidation and voluntary wage restraint will produce significant results by themselves. Moreover, we do not see how the proposed active measures and the increased expenditures involved fit with the goal of fiscal consolidation.

The reluctance on the part of the European Union to confront the impact of the social safety net on labor costs is understandable. The United States is in the midst of the same debate with regard to health care. The need to do so is, however, even more pressing in the Union, where unemployment is high and the social safety net more extended and costly. An important lesson from the recent Detroit Conference on unemployment is that the elimination of out-dated regulations and a new focus on job skills can do much to encourage employment without creating the large income disparities that social safety nets are intended to ameliorate.

A word on federalism: federalism is messy. If Europe waits for all economic policies to be perfectly coordinated and all institutional mechanisms to be put in place, I am afraid it may never take that last step toward union.

Mr. Evans observed that the Fund did not have a direct legal relationship with the European Union or with the Commission, but rather with member states. It was therefore not appropriate to talk about Article IV relations between the Fund and the Commission or the European Union as a whole. Moreover, the European Commission did not necessarily express the views of member states individually or jointly. In his view, the outcome of the current discussion should be an enhanced understanding of the European Union that would enrich Article IV discussions with individual EU members.

He agreed with Mr. Marino that the creation of a monetary union was an act of political will, Mr. Evans stated. But that creation would succeed only if political will was matched by economic realities. For instance, one of the useful lessons of the recent debate on unemployment and its causes was that the conditions laid down in the Maastricht Treaty for monetary union were necessary but not sufficient to address the problem of unemployment. The Fund had a continuing role to play in making those economic realities clear to member states, in whatever way was most effective.

Mr. Posthumus said that while he agreed with Mr. Evans that from a legal standpoint, there could be no Article IV consultations with the EU as a whole, but from the Fund's viewpoint, such regional surveillance was in the global interest as well as in the interest of EU members. The Fund should not be reluctant to comment on developments in the EU that were important for the countries concerned as well as for the rest of the world.

The Chairman observed that Mr. Posthumus had taken a nuanced view on an extremely difficult problem for the staff and for the Board. While he would follow that view willingly, EU members still exercised monetary sovereignty at the current stage, and some appeared to be reluctant to have the Fund look at the EU as a whole and provide candid opinions on certain issues of interest to the EU as a whole and to individual members. He would be interested in the views of other Directors on the matter.

Mr. Al-Jasser said that before the Board addressed whether there should be Article IV consultations with the European Union, a conceptual, and perhaps legal, question had to be addressed: if a group of countries delegated certain decision-making prerogatives to a supranational organization of their own choice, and if the Fund could claim that it had a mandate for surveillance over those policies, where would the Fund draw the line between surveillance vis-à-vis individual countries and surveillance vis-à-vis that supranational body?

Mr. Lanciotti remarked that he was not sure that regional surveillance required the existence of a supranational body. A good starting point for regional surveillance would be to conduct Article IV consultations with individual members with an awareness of their links with other countries of the region.

Mr. Smee said that he agreed with Mr. Lanciotti that the existence of a supranational authority was not a prerequisite for regional surveillance. For example, it had been suggested that the Fund should look at the North America Free Trade Agreement (NAFTA) countries to see whether the benefits to the rest of the world from greater growth in those countries outweighed the trade diversionary costs. Such regional surveillance did not involve a supranational authority, but in view of the general interest in NAFTA and impact on the global economy, it was consistent with the Fund's surveillance role.

Another example was the Organization of Petroleum Exporting Countries (OPEC), Mr. Smee observed. When certain countries entered into an arrangement to influence the price of oil through controlling its supply, the Fund did not ask them whether it was appropriate to comment on OPEC policies in terms of their impact on the economies of OPEC countries or Fund member countries. That was the kind of regional or noncountry-specific issue that the Fund should be examining as a global institution.

Mr. Schoenberg stated that he saw a certain difference between a discussion on regional issues or interesting economic subjects, and an Article IV consultation discussion. The Fund could discuss any aspect of any regional matter, but in the context of an Article IV consultation, it could only discuss policies meaningfully with those who were responsible for them, and at present, for a discussion on monetary policy in Europe, there was not a sole responsible European interlocutor.

Mr. Posthumus observed that discussions with the 12 central banks and 12 Ministers of Finance of the EU could be Article IV-like, because their policies were being coordinated and had an effect on individual EU members as well as on the outside world. The only precondition for doing that effectively was that the Fund and its membership must show that they accept the aims and purposes of the Union, in particular, in the field of exchange rate policy. It was not clear so far that the Fund had met that precondition, as some discussions on the aftermath of the second EMS crisis had made clear. In the case of an EU country, however, the basic policies leading to EMU were being accepted by the Fund, and it should tell them under what conditions their policy objectives could be realized.

The Chairman recalled that from the outset, the Fund had accepted European undertakings with respect to monetary coordination and common exchange market policies. Moreover, that acceptance had been confirmed on the occasion of each Article IV consultation with each EU member. It should also be noted that the conclusion of an Article IV consultation discussion was a jurisdictional decision of the entire Board. So far, the Board had on occasion expressed reservations or doubts about the appropriateness of the policy approach of individual EU members, but it had not questioned the legitimacy of their undertakings with respect to EMU. In fact, the Fund and the EU served a common purpose, namely, promoting exchange stability--the Fund at the world level, the EC at the regional level--so as to promote stable and sustainable growth and thereby contribute to high levels of employment and real income.

Mr. Smee made the following statement:

> The staff paper makes an important contribution toward enhancing the Fund's surveillance from a regional perspective. It is mainly factual in nature, containing a useful overview of recent efforts in the coordination and surveillance areas, particularly with respect to the public finances and labor market strategies, institutional and policy developments, and relations with countries in transition as well as a progress report on the internal market. Looking ahead, I would expect the staff to build on this work to draw out more substantively the impact of European Union not only on countries inside the Union and their common goal of EMU but also on countries outside the Union and world financial markets more generally.
>
> I would like to focus my remarks today on policy coordination and surveillance, a topic of particular importance if the goal of economic and monetary union is to be achieved in Europe. It is also of interest to Fund members more generally as we attempt to enhance and fulfill the Fund's own surveillance mandate.

Spillovers from national policies have long been important to Europe. However, the objective of achieving EMU within a specific, and ambitious, time frame has added a new urgency to finding more effective mechanisms for coordinating macroeconomic policies and disseminating information on the coordination of those policies.

As to fiscal policy, the convergence criteria is far from being satisfied in most EU members. Part of this reflects the deep recession. However, in a number of European countries there has been a deterioration even in the cyclically adjusted budget balances during the past few years. In three of the four major European economies, structural deficits presently exceed the Maastricht criterion for overall deficits. This implies that even a robust recovery will not alone be sufficient to meet the goals set for EMU. According to the last world economic outlook, only a handful of countries are projected to reach a general government deficit of less than 3 percent of GDP by 1996. More ambitious medium-term plans for deficit reduction, increased vigilance in adhering to the medium-term plans, and more willingness to take additional measures to meet the plans' targets are called for if the European Union's own goals are to be met.

Members of the Union recognize this and have put in place an "excessive deficit procedure." But will this surveillance mechanism produce the policy action needed, namely, will it be able to bridge the gap between EU-wide targets and member country actions?

One problem I can see arising on the "excessive deficit procedure" is reluctance on the part of Council members to invoke such a procedure, as--depending on the country in question--it may call into doubt the feasibility of EMU itself. This is not just an adding-up issue. One country's lack of policy action can affect other countries' ability to meet their own goals. The larger the country, the closer they are to the end of Phase II and the beginning of Phase III, the more important this becomes economically and politically. As well, if the excessive deficit procedure needs to be applied to too many members, especially close to the target date of 1996, financial markets could react unfavorably, leading to spillovers in exchange rates and, thus, affecting another condition specified for convergence under Maastricht--maintaining stable exchange rates.

In recognition of these and other problems, it has been suggested to have a multitrack system to EMU. Another alternative is to use, more flexibly, the room that exists now for exchange rates to move within the ERM. This is a change that, I believe, would not compromise the ultimate goal of EMU, but help it.

The second consideration is real shocks. Between now and the end of the decade I am sure there are going to be some asymmetric shocks that will require real exchange rate adjustment. The only question is how this adjustment will occur: through nominal exchange rate changes or domestic price changes? Experience suggests that it is easier to adjust nominal exchange rates. This need not compromise other policy objectives, such as price stability, if other policy levers are being appropriately managed. With such a short and ambitious time frame to achieve EMU, we cannot afford another situation as in late-1992/93, when the lack of agreement to change nominal exchange rates and the lack of political commitment to adjust policies.

As to monetary policy and the European Monetary Institute, it is unclear how effective a shadow central bank can be in influencing the setting of EU-wide monetary policy without transfer of monetary policy sovereignty from the national level. It simply has no teeth. While moral suasion is a possibility, its effectiveness depends clearly on how much the member countries, but particularly the anchor currency country, put in store of EU-wide monetary policy considerations.

On labor market policies, I concur with the staff that it is unfortunate that in the effort to avoid "diluting the European labor market model," the European Commission's White Paper de-emphasized labor market regulation and welfare reform. To address the "ratcheting up" of unemployment observed in Europe over the past two decades, it is necessary to consider a broad range of responses to improve the flexibility of labor markets. In this regard, I note that the European countries along with Canada endorsed the recently published OECD Employment/Unemployment Study, which underlines the need for greater labor market flexibility. It is hoped that this study will contribute positively to domestic policy discussions on this issue in all our countries, not just in the EU.

To conclude, the staff paper and our discussion today has laid the groundwork for improving the Fund's surveillance as Europe moves toward economic and monetary union. We need to follow up on this work so that we can continuously be evaluating the progress being made toward economic and monetary union in order to address more specifically its impact on countries outside of the EU.

Mr. Autheman made the following statement:

I do not intend to make a general statement on this paper as I fully share the views that have been expressed by Mr. Lanciotti at the beginning of our meeting. I will limit my comments to what we should do in the future. Should we move toward an Article IV-type exercise, or should we keep a specific approach? Metaphors are often misleading. I can identify three areas of substance for further Fund surveillance vis-à-vis EU developments.

The first, already mentioned by Mr. Lanciotti, is related to the reference that the European experience can provide to other countries. Is there a paradigm of integration, or are there innovations that could be usefully copied? I will take one example: banking regulations have been harmonized in Europe to a point that exists nowhere else. I could cite many other examples. As the trend around the world is one of increased regional integration, there are many lessons to be derived from the European process.

The second point is related to EMU. Like it or not, the treaty has been ratified, and the heads of states and governments have expressed several times their commitment to implementing it. This is a unique example of a situation where the details of policy are written down in advance, that is, the details of the conditionality of EMU: the debt/GDP ratio, the deficit ratio, inflation performance, and interest rate performance. We all know that the road to EMU is going to be difficult, and many countries think that until now the road is realistic--a judgment that I share. We may benefit from Fund advice, regarding the consistencies of our policies and thus the credibility of our common goal. I am sure that the more we are encouraged to implement fiscal consolidation, the better our chances of achieving that goal.

The third point is the one made by Mr. Shaalan: European countries are small markets taken in isolation, perhaps with the exception of Germany, but Europe taken as a whole is a big market, a source of externalities for other countries. The assessment of the impact of European policies and developments for other countries is important. One aspect is the enlargement prospects--the ones already agreed upon and those that will have to be discussed in the coming years. There are also countries that have close links with the European Union but that still remain outside the European framework. Whether they are free riders or not, it is useful to assess the consequence of European developments for them.

All of these items are of enough substance to be studied on their own merits, without trying to invent a specific form of surveillance ahead of political innovations in Europe.

Ms. Srejber made the following statement:

I would like to thank the staff for the interesting papers, which provide a useful overview of the main policy issues in the EU today and the recent institutional developments.

I would like to focus on three topics: the interaction between surveillance of EU and of the Fund, on monetary policy, and on market integration.

As other speakers have pointed out, economic developments in the EU are important not only for the EU itself, but for the whole world. This is also true for other regional organizations, and it is the main reason why this chair supports intensified regional surveillance by the Fund. The Fund should engage in analyzing regional conditions and developments, as well as policies of regional organizations, and the interlinkages and consistency between these and economic policies in the rest of the world. At the same time, the Fund should take into account the strong political will in Europe to establish closer and more binding economic policy cooperation.

It is important to note that there is no conflict between Fund and EU surveillance; they both have the same basic aim, namely, to promote higher growth and better macroeconomic balance. Thus, cooperation between the Fund and the EU in this respect is natural and should contribute to improving the quality of the surveillance of both organizations.

At this stage, however, the relations and contacts will have to be informal, as economic policies are still national responsibilities and not those of the EU institutions, and as the Fund has no legal relation with the EU, but with the individual countries. One important way for the Fund to contribute in this process is to write analytical reports on EU policies and developments, such as the one we are discussing today.

With the establishment of the European Monetary Institute, a stronger framework for the coordination of monetary policy has been created. Thus, the surveillance of the Institute is executed within an institutional framework that has an independent status for both its functions and its management.

Nevertheless, as monetary policy will continue to be a national responsibility in Stage II of the process toward a monetary union, the effectiveness of monetary policy coordination will ultimately depend on the willingness of national central banks to accept and implement common policy guidelines. However, the Institute can be expected to acquire a stronger catalytic role in monetary policy coordination than the former Committee of Central Bank Governors. Furthermore, it will be helpful in this respect that national central banks are becoming increasingly independent of political authorities.

In this way, a better basis is established for enhancing monetary policy coordination, safeguarding price stability and, with the support of fiscal consolidation, assuring exchange rate stability. I do not want to rehearse the arguments for exchange rate stability in Europe, but the important role it plays in European monetary cooperation is a fact that has to be taken into account in our discussions.

A word on market integration: this chair strongly supports market integration. It is important to note, however, that the single market is a dynamic process--not a static one. There will be a continuous need to adapt to new developments and create a level playing field for business everywhere within the area in order to enhance competition.

Furthermore, we attach great importance to the EU remaining an open and free trade-oriented market vis-à-vis third countries. We believe that the relations between the EU and Central and Eastern European countries should be developed further, particularly with regard to trade. We are in favor of a faster pace of trade liberalization than is envisaged in the agreed timetable.

Mr. Glazkov made the following statement:

On the Fund's surveillance of the European Union, or more broadly, of European integration, I would see it as concentrated less on institutional developments and more on common economic policies and economic convergence. In this regard, I fully concur with Ms. Lissakers and with Mr. Evans, who rightly noted that convergence is much more important for exchange rate stability than for regulating institutions and arrangements.

The Fund is a global institution and considering the global implications of European integration is a true mandate of this institution. In accordance with these principles, I will focus on four major policy areas of European union: labor market policies, the common agricultural policy, the EU structural funds, and relations with nonmember countries in Europe.

The strategy envisioned in the White Paper on "Growth, Competitiveness and Employment" is broadly commendable. It clearly takes a stand against policies of demand expansion and protectionism, while relying on fiscal consolidation, wage moderation based on solidarity, and active labor market measures. However, I concur with the staff that the assumptions on which the strategy is based appear to be too optimistic. In particular, it is not clear what circumstances would produce the wage moderation that is assumed in the White Paper's scenarios.

It is most important that the European Union's strategy to reduce unemployment encompass, to a greater extent than currently envisaged, measures that directly attack distortions in the labor market. This primarily includes the reform of the unemployment benefit system to encourage the unemployed to undertake active job searches, and/or retraining as well as reducing the minimum wage in order to tackle, inter alia, the problem of unemployment of young and unskilled workers. The concern that the European labor market model be maintained in order to preserve social peace and to sustain living standards is certainly understandable. Nevertheless, as has been repeatedly pointed out in this institution, these concerns will be much more efficiently addressed by promoting growth and employment through labor market flexibility in combination with training and better-focused income support.

Agricultural policy has always been a headache in the Common Market, subsequently in the European Community, and now in the European Union. Therefore, the attempt to reform the common agricultural policy adopted in May 1992 is welcome. As annual growth of output in agriculture averages 2 percent, compared to demand growth of 1/2 percent, the immediate objective of the reform to make production incentives more responsive to demand conditions is justified. However, as is rightly noted in the staff paper, the reformed system will still be one of minimum prices and trade protection. Hence, its major weaknesses--low efficiency, high budgetary costs, vulnerability to changes in the world market environment, technology or world prices, and complications it creates in international trade negotiations--will persist.

The centerpiece of the reform is the modification of the regime for cereals, where the financial support of farmers is due to be decoupled from output. This is undoubtedly a step in the right direction, but its ultimate efficiency is doubtful, unless supporting measures are taken. Providing a flat payment to farmers per hectare under cultivation, as is envisaged by the reform, is likely to have three consequences: land productivity will be moderated; farmers will be encouraged to continue in the same business that they have been pursuing; and the extent of land under cultivation will be retained.

Only the first of these three outcomes is a proclaimed objective of the CAP reform, and I have reservations about the correctness of this objective. Although it is justified by the environmental considerations, it should be kept in mind that agriculture in EU countries accounts for 6 percent of employment, and only 3 percent of GDP, notwithstanding artificially high prices in this sector. The two latter outcomes are even less desirable. A reasonable policy would instead suggest encouraging a reduction in excessively cultivated land and shifting farmers to alternative businesses--preferably in the rural areas, and perhaps in their own localities.

In general, it appears that the common agricultural policy still lacks a clear formulation of its objectives. Moreover, I would suggest that at this stage, the right way to pursue an efficient agricultural policy in the EU is to design it in concert with two other policies--namely, support of rural areas and environmental protection and development. The current incoherence of these three policy areas is understandable, but hardly permissible. The steps taken toward clarification of objectives and coordination of the above-mentioned policies will be welcome.

The EU's structural funds are another area where good intentions are perhaps not fully in line with ways and means. Although the formulation of objectives is much more advanced in this area than in the area of agricultural policies, the EU's policy in assisting lagging regions appears to contain some risk of miscalculation. The size of the structural fund payments for several member states is in the range of 2.5-3.5 percent of GDP. The eligibility criterion for EU cofinancing is that the latter must be accompanied by the national public investment of at least the same size. Hence, I have difficulty in interpreting the results of the simulation exercise undertaken by the Commission, which suggests that the obligation of the member states to cofinance projects supported by EU structural funds will not hamper the achievement of the Maastricht criteria in the fiscal area.

The two assumptions of the simulation exercise appear to be somewhat odd. The first--that structural fund grants tend to account for most of the financing--is in contradiction to the eligibility criterion mentioned above. The second--that faster growth boosts tax revenue--is correct only in principle. The size of the tax revenue increase will not be comparable with the size of public investment in the cofinanced projects: the latter must account for 2.5-3.5 percent of GDP, while the former will be only a part of an increase in economic growth owing to the structural funds, which is projected in the range of 0.5 percent to 1 percent. We should also take into account that the envisaged projects are additional to otherwise planned expenditure and that the increase in tax revenues may be realized only several years after the investments are made.

Therefore, if I understood the figures correctly, my answer to the question of whether there is a potential for conflict between fiscal consolidation and the requirement of additionality is, "yes." If I misunderstood them, clarification by the staff would be appreciated.

However, I fully support the idea of structural funds. Without policies aimed toward reducing regional disparities, the unity of the EU will hardly be sustainable. What is needed is realistic expectations with regard to the costs and benefits of these policies and perhaps revision of some elements of the policies.

Concerning relations with European countries in transition, the progress achieved in liberalizing trade with the associated members is commendable, but more needs to be done. In some important areas, particularly in agriculture, further progress in trade liberalization requires better coherence in the EU's internal policies.

I would like to note that Chapter 4 of the staff paper--on relations with non-member countries in Europe--misses the analysis of EU's relations with a large group of European countries that do not have association agreements with the Union but are important trade partners. The analysis of these relations by the Fund would be beneficial both for the countries in question and European Union itself.

The Deputy Director of the European I Department said that as Mr. Lanciotti had correctly observed, the staff paper had not covered the work of the Committee of Governors or the work done in individual member countries to adapt their monetary policy framework to the Maastricht Treaty. In determining the paper's scope, the staff had selected those issues that it believed were the most interesting to Directors. In that context, the work of the Committee of Governors was not the focus of the review, and the efforts of individual member countries was, in fact, being covered in individual Article IV consultation reports, particularly those issues related to the monetary framework and the extent of central bank independence. Moreover, while the paper focused on institutional aspects, it did not address the implications for the EU or the rest of the world of the efforts of all EU countries to adjust their fiscal and monetary policy at the same time. In that connection, the staff was looking to the Board for guidance on the issues to be covered in regional surveillance.

The staff did not share Mr. Wei's view that there was more convergence with respect to fiscal policy than with respect to monetary policy, the Deputy Director commented. In fact, there was a great deal of convergence in monetary policy. The fact that there had been a move to wide bands did not really indicate that the convergence had been more limited. Instead, exchange rates had been more stable following the move to a wide band than they had been previously. Clearly, the convergence with respect to interest rate policy had been fairly close over the past 12 months or so.

As to fiscal policy, there had been some convergence, but not a great deal, the Deputy Director continued. At the same time, he did not share Ms. Lissakers's view that the fiscal deficit target for 1996 of 3 percent might not be realistic. Currently, as the recession ended or neared an end in most EU countries, if the three countries with the largest deficits were excluded, the average deficit for the rest of the EU was only 4 1/2 percent of GDP. If 1995 and 1996 were years of recovery, an adjustment from 4 1//2 percent to 3 percent would not be challenging.

Although it was true that in Phase II each member country was fully responsible for its own monetary policy, it was also true that the Fund had a clear mandate with respect to surveillance of member countries, including in the area of monetary policy, the Deputy Director observed. As the objective of monetary union was to have a central institution with a strong mandate with respect to surveillance of monetary policy, Mr. Schoenberg's observations on the relative strength of EU and Fund surveillance was difficult to explain.

In concluding, it was striking that every Executive Director representing EU countries had agreed with the staff that the White Paper should have gone further in stressing the need for labor market reform, the Deputy Director of the European I Department stated.

Mr. Lanciotti said that he had not commented on the labor market and wished to differ with the staff view. The staff paper had noted the lack of emphasis in the Commission's White Paper on measures aimed at increasing labor flexibility. It should be noted in that regard that the European labor market was segmented into national markets whose specific features prevented agreement on uniform measures at the Community level. In the circumstance, he wondered whether it was appropriate and realistic to assume as a model for Europe the paradigm of a perfectly flexible labor market, which implicitly was a reference to the U.S. case. In fact, the Detroit conference had pointed out that unemployment problems could not be totally linked to the flexibility of labor markets.

The staff representative from the European I Department, commenting on co-financing and EU structural funds, explained that for commercially-oriented--namely, revenue-yielding--projects, such as telecommunications, the European Union provided 50 percent of the financing. For those projects that were not commercially oriented--for example, road building--the European Union provided 75 percent of financing. As to cohesion funds, which were set to benefit four regions, the co-financing was higher, at 80-85 percent. As to the impact of EU structural funds on the general government deficit, commercial projects would probably fall outside the deficit criterion because the agencies responsible for them were generally outside of the General Government. To the extent that the Central Government participated in the financing of such projects, it was in the form of lending rather than grants, which was below the line for the general government deficit. Nevertheless, governments, even at the higher level of co-financing, would have to finance some project expenditure.

In terms of revenue benefits, the projects were all investment projects and while he did not know the appropriate capital output ratio for such projects, it was unlikely that the additional revenues deriving from the growth effects would be dramatic, they would not be trivial, the staff representative from the European I Department stated. The co-financing that was not covered by additional revenue would have to be found by governments, and there would be some need to restrain government expenditure or raise additional revenues as needed to meet the Maastricht criteria.

Mr. Schoenberg said that the net effect of the additionality of national fiscal contributions to EU-financed projects could only be assessed by making certain assumptions regarding the extent to which they added to or substituted for national projects. It was therefore necessary to know the investment structure of the country with and without such assistance.

In remarking on the relative strength of surveillance of the Fund and the European Union, he wished to make clear that he was not referring specifically to monetary policy but to surveillance in general and the conditionality attached to the lending of the two institutions, Mr. Schoenberg stated.

The Chairman made the following concluding remarks:

> Against the background of the Fund's efforts to strengthen surveillance of regional developments, Directors welcomed this opportunity to discuss, in informal session, a broad range of issues related to policy and institutional developments in the European Union. Indeed, Directors have emphasized that regular contacts and discussions between the Fund and the EU institutions and member countries form a vital link for enhancing the regional focus of Fund surveillance, and a number of speakers have focused their remarks particularly on these surveillance issues. In that context, the staff paper was seen to be another useful step toward enhancing regional surveillance of the European Union. The staff was invited to build on this work and on the seminar discussion with a view to drawing more substantively on the impact of EU policies on EU members themselves, and on other countries.
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> In this context also, Directors remarked on the important strides that the Union has made in strengthening the institutional framework for the surveillance and coordination of macroeconomic policies--a development that is important not just from the perspective of the Union's own goals of further economic and

monetary integration but also in the context of the Fund's broader interests in fostering conditions that promote a prosperous and stable world economy. Directors particularly welcomed the establishment of the European Monetary Institute, which will have a crucial role to play in laying the foundations of European Monetary Union. Directors also recognized the work carried out at the national level in order to fulfill the obligations deriving from the Maastricht Treaty, and in particular, the important reforms aimed at establishing the independence of central banks and the work of the Committee of Governors to ensure that the EMI is given a strong foundation.

Directors have remarked on the increasing importance of assessing, on a continuous basis, developments in Europe and their implications for the global economy. Here, contact between the Fund and EU institutions, particularly the EMI and EU members, is especially important, not only for enhancing the effectiveness of Fund surveillance over the policies of individual EU member countries but also for contributing a global perspective to policy coordination within the Union. While Directors generally see EU surveillance and the Fund's regional surveillance as mutually reinforcing and are agreed on the importance of ongoing Fund contacts with regional institutions, there is some divergence of views regarding the form that our surveillance and contacts should take. While many Directors have urged a regular informal exchange of views between the Fund and the European institutions, some others have suggested that there might be regular Article IV or Article IV-type consultations with the European Union--"a global institution looking at the global implications of regional policies," while several Directors--stressing that responsibility for monetary policy in the Union continues to rest with national authorities--consider formal consultations with the European Commission to be inappropriate and have reminded us that "policy discussions can only be meaningful if held with those responsible for them."

I have taken note of Directors' suggestions on areas where the Fund should be "proactive"--inter alia, ensuring that EU and Fund surveillance avoid overlap; advising on the credibility of the programs for moving to EMU; assessing the impact of an enlarged European market on other countries; and reviewing the lessons that the EU experience can provide for other countries, for instance, regarding the integration of banking regulations.

Turning now to the issues raised in the staff paper, Directors observed that the EU objectives are such that more ambitious policies will be needed if they are to be achieved in accordance with their timetable. The staff and the Executive Board needed to explore what would be the fastest and surest way for the members of the Union to reach their goals. Directors also observed that EU members, as well as the rest of the world, had a stake in meeting its goals and in avoiding another setback such as had been experienced in 1993. Convergence was a necessary but insufficient condition for the achievement of monetary union. In that light, Directors considered that fiscal consolidation still had a long way to go and the strategy to reduce unemployment would need to give much greater emphasis to labor market deregulations, removal of distortions, and welfare reform. Budgetary consolidation also has still a long way to go, and I noted that a few Directors considered that, even if the journey is long, it should not start prematurely, while a few others observed that the journey should not be delayed until the path is perfectly prepared. All this, several speakers emphasized, argued for laying the groundwork for effective Fund surveillance over the European Union.

Concerning the EU's common policies, there is a broad consensus that the steps taken to promote further integration of internal markets have represented a notable achievement. Policies specifically directed at market integration have been complemented by reforms in the common agricultural policy and trade liberalization with countries in transition in central and eastern Europe. In agriculture, Directors noted that the degree of protection provided by the CAP was being lowered considerably, but some stressed that more remained to be done, observing in particular that the system remained one of minimum prices and trade protection, with important barriers to market access. Concerning the association agreements with countries in central and eastern Europe, Directors were generally impressed with the speed of liberalization for industrial products, although there were some concerns about the uncertainties posed by the use of safeguard and anti-dumping clauses.

In recognizing the important strides in strengthening the Union's institutional framework for the surveillance and coordination of macroeconomic policies, Directors have remarked on the extent to which the enhanced surveillance process entails the formulation of broad-ranging economic strategies at the Union level, with quite specific goals set in some areas of policy. We found ourselves in broad agreement with the general aims of the macroeconomic strategy outlined at the December 1993 meeting of the European Council, as well as with the need in the current circumstances to focus on imbalances in public finance and on unemployment. With respect to specific policies, the Union-wide goals that have been established in the fiscal area are consistent with what we have been recommending in the context of the WEO and our Article IV consultations. In the area of the labor market, however, while there is much that is worthwhile in the Union's strategy, Directors generally believe that the unemployment problem cannot be tackled effectively without greater emphasis on measures to address the adverse incentives resulting from minimum wage and other labor market regulations and from overly generous welfare benefits.

We will have to reflect further on the issues that Directors have raised in the course of our seminar, particularly as they relate to our surveillance procedures. In the future, we will, as you have urged, focus more on policy rather than institutional developments and broaden the scope of our work to cover, among others, issues related to interaction between the European Union and countries outside Europe, and the impact of convergence criteria and prospects for EU enlargement on Europe and on the global economy. I take reassurance from views expressed by Executive Directors that EU surveillance guidelines need to remain fully convergent with the Fund's own surveillance.

I will certainly be in touch with members of the Board before the next steps in our conversations with European countries and institutions to make sure that all of that is handled according to the consensus of this Board.

LEO VAN HOUTVEN
Secretary