

I. The present state of and perspectives for economic and monetary integration in the Community

1. Introduction

1. This section will briefly recall the main features of the process of economic and monetary integration in Europe since the beginning of the 1970s. In particular, it will make reference to:

- the Werner Report, which presented a first attempt to define and set out a plan for the attainment of economic and monetary union;
- the perception by the mid-1970s that the process of integration had lost momentum; nonetheless a number of significant developments took place in the Community both in monetary areas (notably the establishment of the EMS) and in non-monetary fields;
- the new impetus to European integration in the mid-1980s, as reflected in the adoption of the internal market programme and the signing of the Single European Act;
- the fact that progress in one area has promoted advancement in other areas and that integration has now reached a stage where it is practically irreversible.

2. The section will conclude with a brief statement to the effect that the Community has proved able to overcome serious problems, has expanded as a result of the accession of new member countries and has revived the idea of economic and monetary union. In particular, it will stress that the Community is now on the move and that it has put its house in order by resolving the most urgent budgetary and policy issues.

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1. Introduction

- 1) Efforts in the Community to progress towards full economic and monetary integration began in earnest as the Bretton Woods system was breaking up. The Werner Report on the realisation by stages of economic and monetary union was drawn up in 1970 against the ~~Community~~ background of the end of the transition period leading to the completion of the customs union, and of the definition of the common agricultural policy. It presented a first attempt to define and set out a plan for the attainment of economic and monetary union.

By the mid-1970s the perception had grown that the process of integration had lost momentum under the pressure from the divergent policy reactions to the economic crises occurring at the time. Nevertheless, several important institutional moves had been made: in 1972, the "Snake" was created; in 1973, the European Monetary Co-operation Fund (EMCF) was set up; and in 1974, the Council Decision on the attainment of a high degree of convergence in the Community and the Directive on stability, growth and full employment were adopted.

European Monetary Co-operation

- 2) In 1979, the process of monetary integration was relaunched with the creation of the EMS and the ~~ECU~~. The success of the EMS in promoting its objectives of internal and external monetary stability laid the foundations for the new impetus to European integration in recent years, as reflected in the adoption of the 1992 large internal market programme and the signing of the Single European Act.

The fact that the 1992 internal market process has now become practically irreversible, proves that the Community has been able to overcome the serious problems of the 1970s, and has coped with the enlargements resulting from the accession of new member countries. The idea of economic and monetary union has been revived now that the Community has put its house in order and resolved the most urgent budgetary and policy issues. The Community is once more progressing along the path of economic and monetary integration.

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European Monetary System

2. The EMS and the adjustment of the European economy

3. In the monetary field a new phase in the process towards an economic and monetary union opened with the creation of the European Monetary System <sup>(EMS)</sup> at the end of the 1970s. The progress made by the Community in the 1980s towards price stability, ~~fiscal and structural adjustment~~ <sup>growing monetary cooperation</sup> and greater economic integration owed much to the ~~European Monetary System~~ <sup>EMS</sup>.

4. Within the framework of the EMS the Community has developed into a zone of increasing <sup>while gradually relaxing capital controls. This achievement was particularly remarkable</sup> monetary stability ~~and open internal trade~~, in a period in which the world economy was shaken by wide exchange rate fluctuations and tensions in trade relationships. The acceptance of the exchange rate constraint has greatly <sup>helped</sup> assisted the participating countries in gearing their monetary policy towards the objective of price stability, thereby laying the foundations for both a converging price performance at a low rate of inflation and the <sup>achievement</sup> of a high degree of exchange rate stability. Moreover, <sup>the</sup> greater priority <sup>affirmation</sup> given to a policy of monetary stability has <sup>promoted</sup> contributed, in many countries, to a ~~process of economic adjustment obtained through budgetary restraint and moderation in cost increases~~ <sup>and leading to an improvement in the overall performance of the economy.</sup> Finally, the reduced uncertainty about exchange rate developments and the fact that the parities of the participating currencies were not allowed to significantly depart <sup>from</sup> the fundamental economic <sup>parameters</sup> conditions of the respective countries, <sup>facilitated and</sup> created a condition favourable to the maintenance and strengthening <sup>of</sup> ~~of open~~ intra-European trade, even in a period of <sup>high</sup> great economic difficulties and ~~severe~~ <sup>severe</sup> unemployment.

The EMS has served as a focal point for improved monetary policy co-ordination and provided a basis for multilateral surveillance within the Community. Its success is in part attributable to the willingness of countries to opt for a strong currency policy stance, but also to the flexible and pragmatic way in which <sup>the system</sup> it has been managed. The ~~System~~ <sup>EMS</sup> has evolved in response to changes in the economic and financial environment and on two occasions (Palermo 1986 and Basle-Nyborg 1987) its mechanism has been amended and improved.

<sup>Was the important element in</sup>  
5. The launching of the European Monetary System was accompanied by the creation and development of the ECU, which replaced the European unit

of account. In setting up the EMS, the European Council declared in 1978 that "a European currency unit (ECU) will be at the centre of the EMS". (A)  
~~Beyond being used as the denominator of the deposits with the EMGF obtained against gold and dollars conferred through the swaps mechanisms, and as a denominator of intra-EMS credit facilities, the "official" ECU has had a limited development and role in the EMS so far. The use of the ECU by private markets, however, has spread significantly, partly because of its intrinsic advantages and partly as a result of a perception that it could become the future currency of Europe.~~

~~The ECU has strongly developed as a financial instrument in private markets. In international banking it has become the sixth <sup>most important</sup> currency of denomination. The creation of an ECU clearing system two years ago, in which more than thirty commercial banks now participate, has contributed to the development and the liquidity of the market. The ECU also ranks fifth as a currency of denomination of international bond issues, with 6% of the market. A wide set of new instruments is now available for investors, both with short and long maturities. In the non-financial sphere the use of the ECU remains limited, because of the scarcity of information and the difficulty to introduce innovations in the currency denomination of commercial transactions.~~ However, opinion polls, especially among firms, (R) tend to show an increased interest in the potential uses of the ECU.

### 3. The Single European Act and the Internal Market Programme

6. On the economic side, a "relaunching" of Europe began in the mid-1980s supported by the success and ~~resilience~~ of the EMS. The central element in this process was the proposal, made in May 1985 by the Commission, to realise the objective of a market without internal frontiers by 1992. The essence of the measures for the removal of physical, technical and tax barriers was set out in a White Paper, which specifies the programme, timetable and methods for creating a unified economic area in which persons, goods, services and capital will be able to move freely. This objective, together with the necessary institutional <sup>steps</sup> ~~means~~, was embodied in December 1985 in the Single European Act which marked the first significant revision of the Treaty of Rome.

(A)

Report from being used as the  
mainframe of the exchange rate mechanism  
and as a denominator for operations  
in both the intervention and credit  
mechanisms. The ECU serves primarily  
as a reserve asset and a means of  
settlement for EMS central banks. To  
fulfil this latter function a stock of  
official ECUs has been created through  
revolving loan arrangements whereby  
participating central banks maintain  
20 per cent of their gold and dollar  
reserves with the European Monetary  
Cooperation Fund. Although an integral  
part of the EMS and despite a number  
of measures to improve its usability,  
the ECU has so far played only a  
limited role in the functioning of the  
EMS.

By contrast, the ECU has gained remarkable popularity in the market place where its use as a denomination of financial transactions has spread significantly. A wide set of ECU instruments is now available for investors, both at the short and the long end of the market. In international banking the ECU ~~now~~ occupies <sup>at present</sup> the place of the fifth most important currency of denomination and it ranks fifth in international bond issues, with 6 per cent of ~~the~~ market <sup>share</sup>. The growing use of the ECU reflects in part the interest of public sector borrowers to develop and tap the market for ECU securities, but <sup>it</sup> must also be attributed to an <sup>important</sup> extent to the ECU's attractiveness as a means of portfolio diversification and hedge against currency risks. Moreover, the creation of an ECU clearing system two years ago, in which by now more than thirty commercial banks participate, has contributed to the development and the liquidity of the ECU market. Despite some financial obstacles, however, the use of the ECU in international and interbank transactions remains limited, covering at present only about 1 per cent of the Community countries' external trade. 14

The most prominent, and certainly one of the most important, examples is the Directive on the liberalisation of capital movements which was adopted within six months and which will come into force on 1st July 1960. Another step in the direction of greater financial integration was the adoption of the Directive establishing <sup>the</sup> freedom to provide insurance services for individual motorists. This directive applies the principle of mutual recognition.





7. The Single Act signalled two significant changes in the Community's strategy to advance in the integration process. Firstly, it incorporated an institutional reform aimed at establishing a faster, more efficient and more democratic decision-making process which was considered to be indispensable for reaching the goal of a common unrestricted market. In particular, this reform extended the scope of qualified majority voting and thereby removed the constraints inherent in the permanent search for consensus which had hampered the decision-making process in the past, gave the European Parliament a greater role in the legislative process, and <sup>greatly</sup> ~~dramatically~~ simplified the requirements of ~~the~~ <sup>ing</sup> harmonisation of national law by limiting harmonisation to the essential standards and by systematic adoption of mutual recognition of national norms and regulations. Secondly, with the Single Act the member countries reaffirmed - and recognised in the context of the Treaty of Rome - the need to strengthen the Community's economic and social cohesion, to enhance the Community's monetary capacity in the perspective of economic and monetary union, to reinforce the Community's scientific and technological basis, to harmonise working conditions with respect to health and safety standards, to promote the dialogue between management and labour, and to initiate action to protect the environment.

*Can a valuable program has been made over the last three years*  
8. Concerning ~~the~~ <sup>the</sup> implementation <sup>in</sup> of the single market programme, ~~the~~ <sup>the</sup> progress made in the last three years (spring 1986 to spring 1989) is very significant and highlights a <sup>marked</sup> ~~complete~~ change of pace in approaching a unified market, as compared to the <sup>development during the</sup> previous two decades.

The ~~effective~~ <sup>work</sup> realisation of the internal market ~~between now and~~ 1993 involves the adoption of some 300 Directives. ~~It is not so much their~~ number which is impressive, ~~as the extremely short period of time available~~ for their adoption, because in view of the time required for them to be transposed into national legislation, the bulk of the Community's legislative work should be completed by the end of 1990. In three years the Commission has presented 90% of the proposals for the Directives concerned and the Council has adopted around ~~50%~~ <sup>one half</sup>. ~~Whereas eighteen and sixteen years~~ <sup>respectively</sup> ~~were needed to put through two Directives on the freedom of~~ establishment of architects and pharmacists, ~~two years were sufficient for~~ the adoption of a general system for the mutual recognition of higher education diplomas. Particular diligence is being displaced in dealing with

*Harmonizing technical barriers relating to*  
~~the texts concerning the abolition of technical barriers. The speedy adoption of the Directives on the liberalisation of capital movements (achieved in six months) and the freedom to provide insurance services for industrial risks (the adoption of which was made possible by the application of the principle of mutual recognition) has been particularly striking. Rapid and significant progress has been made with regard to machines, materials, foodstuffs, public works and supply contracts, sea, air and road transport and financial services. Progress is slower <sup>but</sup> ~~regards~~ <sup>has advanced less quickly... so far...</sup> the abolition of tax barriers and physical barriers. The speedy application of Community law connected with the internal market will be served by greater delegation of implementing powers to the Commission; by various measures to ensure the transparency, efficiency and legal certainty of the procedures governing the conduct of the Community's competition policy, whether in the field of merger control or state aids; and by the forthcoming establishment, alongside the European Court of Justice, of a court of first instance, in particular specialising in competition questions.~~

Concerning the Community policies accompanying the creation of the single market, a package of measures was approved by the European Council in February 1988:

- the reform of the Common Agricultural Policy has been continued to take account of new production and trade conditions;
- substantial resources have been allocated to the Community's structural policies (in particular the doubling of the structural funds by 1993 and the adoption of a framework programme for research and technological co-operation). Their objectives have been built around a few major priorities: to strengthen the scientific and technological bases of European industry, with a view to developing its international competitiveness; to take on the challenge of the economic and social cohesion of the Community by achieving growth and adaptation in regional economies showing structural backwardness, by supporting the conversion of declining industrial regions, by combating long-term unemployment, by integrating young people into employment, and by encouraging rural development; to support the realisation of large infrastructures of European interest and to

(D)

9) The creation of a single market <sup>is</sup> however, not be  
optimal solely <sup>based</sup> by the elimination of micro-economic market  
barriers but <sup>comprises</sup> also <sup>a range of</sup> measures to avoid market  
segmentation through restrictive commercial practices and  
dominant market positions as well as Community policies  
aimed at reducing market imperfections. In the field of  
of competition policy, the Commission's activities to apply Com-  
munity law governing the internal market will be strengthened,  
especially measures will be implemented to increase the  
● transparency, efficiency and legal certainty of the procedures  
of the Community's competition policy and a court of first  
instance, specialising in particular in competition questions, will  
be established alongside the European Court of Justice.

As for <sup>Community policies</sup> complementary cooperation policies, the Commission,  
the European Council approved the package of proposals, policy  
of proposals of which deal with both the market imperfections and  
and European policy imperfections and proposals proposals proposals proposals  
reducing market imperfections and safeguarding the economic  
● and social cohesion of the Community. The package includes  
the Community policy imperfections proposals proposals proposals proposals  
and trade conditions. Secondly, the adoption of a new  
financial reform which provides a firm footing for  
Community activities on the basis of a system of own  
resources. Thirdly, the Community policy imperfections proposals proposals proposals proposals  
Community's policy imperfections proposals proposals proposals proposals  
the Community policy imperfections proposals proposals proposals proposals  
which have been established by 1993 and, together with a new package

of policies away from project to programme principles will  
enable the Community to promote <sup>more effectively</sup> growth and adaptation in  
less developed regions, and a restructuring of European industry.  
Moreover, with the adoption of a framework programme  
for research and technological cooperation the Community will  
be able to strengthen the scientific and technological foundations  
of European industry and help them to exploit the advantages  
of an enlarged market.

(F)

①

There is indeed widespread evidence that the objectives of a single market enjoys broad support by consumers and producers and that their economic decisions are increasingly influenced by the prospects of 1992. Price liberalisation effects are clearly reflected in the investment strategies of European firms and the unprecedented number of mergers forecasting a growing industrial cooperation. These developments have generated a new dynamism and certainly contributed to the recent acceleration of economic growth in the Community.

(17) The implementation of the single market will entail a profound structural changes in the economies of the member countries. The abolition of market barriers will link national economies much more closely together and significantly increase the degree of economic integration within the Community. These changes will offer immense opportunities for economic advancement but they also pose a number of potential risks. One of the main risks of economic policy-making is a gradual deterioration of the structural changes. As the opportunities arise because of a unified, enlarged economic space, greatly increases the freedom of choice of market participants, generates <sup>large</sup> ~~immense~~ possibilities for exploiting economies of scale and comparative advantages, and reduces <sup>the</sup> adjustment costs of intra-Community trade. There can be no doubt that these changes prepare the ground for a more efficient use and allocation of resources with beneficial effects for trade, growth and employment. However, the extent to which these gains can be achieved will depend critically on the degree of certainty in financial integration. The decision-making





12) The benefits of economic and monetary union would derive from three interrelated developments. Firstly, the strengthening and expansion of common policies provided at the Community level would help to correct market imperfections which operate on a Community-wide scale and could therefore not be satisfactorily dealt with at a national level. This applies to research and development, where Community policies would promote the pooling of resources, help to avoid duplication and facilitate the dissemination of information. Similarly, common structural policies could prevent a competition among national incentive schemes which, without a certain degree of intervention at the Community level, would tend to neutralise each other and lead to a waste of scarce economic resources. Large productivity gains for the Community as a whole could also be achieved, by organising on a Community scale the provision of cost-effective public goods such as infrastructure for transportation, environment and long-distance energy transmission. Finally, and perhaps most importantly, the Community structural policies would help to develop a more balanced economic structure throughout the Community and thereby prevent the emergence or aggravation of regional and sectoral imbalances.

13) Secondly, a closely coordinated management of macro-economic policies is not only vital for the cohesion of an economic and monetary union, but it also offers the possibility of <sup>synergistically</sup> exploiting to the reciprocal room for manoeuvre under a cooperative strategy <sup>by knowing a clearly defined framework for policy-making</sup> <sup>the interdependence of</sup> and thereby attain a higher rate of growth and employment.



economic developments in individual countries would be automatically taken into account and thereby ensure the most favourable outcome from the interaction of national policies. For instance, the Cassin Report estimated that the impact of the internal market programme on growth in the Community could be offset by 2½ percentage points if the removal of market barriers were accompanied by an active macro-economic policy in the Community. This economic and monetary union would greatly intensify the chances of a complementary, high quality, well-structured growth-oriented strategy.

If finally, in leading to a single currency area in economic and monetary union would establish the conditions under which a common market could fully develop its potential. A single currency area would imply the permanent fixing of exchange rates - or the adoption of a single currency - participants in the single market would benefit strongly from three developments: exchange rate uncertainties with regard to intra-Community transactions would be eliminated, the cost of transactions between members of different Community countries <sup>lowered</sup> and the homogeneity of prices and, therefore, the inflationary pressure to avoid price discrimination would be decreased. These three consequences would not only provide greater certainty for economic decisions and planning, they would also reinforce strongly the competitive forces of a common market and enhance its allocative functions. The existence of irrevocably fixed exchange rates would, moreover, dispel the fears of a devaluation and, thereby, participants would be able to reap a compensation for



promote a European approach to environmental problems. New thinking has been applied to the methods of implementing these structural policies: the concentration of resources, the selection of actions which are sure to have a strong multiplier effect, the substitution of the concept of programmes for that of projects, and the introduction of a partnership between the Community and the beneficiaries;

- finally, it should be noted that the European Investment Bank will also have to contribute to the objective of economic and social cohesion, in proportion to its substantial resources.

At the same time, the Community has adopted a new financial regime which provides it with a system of own resources which is adequate, stable and guaranteed, thus ensuring the continuity of Community activities. It also establishes the procedure for greater budgetary discipline on the basis, firstly, of an institutional agreement between Parliament, Council and Commission on the ceiling for budget resources year by year from now until 1992; secondly, of a multi-annual approach to the planning of expenditure; and finally, the strengthening of the principle of budget "annuality" in the execution of the budget.

#### 4. Perspectives, opportunities and problems

10 g. The European Council, meeting in Rhodes in December 1988, noted that "at the halfway stage towards the deadline of December 1992, half of the legislative programme necessary for the establishment of the large market is already nearly complete" and underlined "the irreversible nature of the movement towards a Europe without internal frontiers".

~~Among economic agents, the objective of a large market without internal frontiers enjoys broad support, emanating to a significant extent also from the dynamic forces that the objective of 1992 has created at every decision-making level. In the private sector the anticipation effects are clearly reflected in the investment strategies of European firms and the unprecedented number of mergers foreshadowing the intensification of industrial co-operation. The prospects of a single market, the credibility of the member countries' desire to move towards a highly integrated Community and the enhancement of the decision-making capacity of Community~~

15. The move to economic and monetary union would also increase considerably the "controlling" (concept... the world's economy) ~~and~~ strengthen its role in international cooperation and

bodies are having a strong impact on the behaviour of market participants in the Community.

10. The advantages deriving from the completion of the internal market are, in terms of economic welfare and greater freedom for the European people, deep and widespread because of the very deep structural change in the European economy required and promoted by the establishment of the single market. Such change will not only involve regulatory and other policy aspects for which a competence will have to be established at the Community level, it will also involve the conditions under which policy functions that remain a preserve of national authorities will be exerted. This is so because the degree of economic interdependence among member countries will be significantly strengthened by the single market, thereby enhancing the repercussions that each economy will receive from impulses originated in other member states. In the economic field, the dismantlement of all physical, regulatory and tax barriers in the exchange of goods and services will increase and accelerate the cross-frontier effects of cost and budgetary developments originating in each member state. In the financial and monetary field, this effect is going to be even stronger, following the complete liberalisation of capital movements that will become effective in most member countries by mid-1990.

11. The maximum benefit from the creation of the single market can be brought about only through more stable exchange rates and closer co-ordination of economic and monetary policies. An efficient allocation of economic resources in a wide, integrated space will only be possible in a framework of exchange rate stability. If the flexibility and scope for parity adjustments offered by the present EMS arrangements were to be intensively used to cope with pressures on exchange rates originating from financial disturbances, real exchange rates would depart from economic fundamental conditions, and investment and consumption decisions by economic agents would be made inefficient by such misalignments. In order to avoid such developments a close degree of macro-economic policy and monetary policy co-ordination is indispensable, as well as the enhancement of the resilience of the EMS. A lack of co-ordination would inevitably lead, sooner or later, to mutually inconsistent policies being conducted in different countries. Such inconsistency would eventually produce imbalances

in Community exchanges of goods and services and would, in turn, feed the illusion in some political quarters that the tensions could be relieved by protecting some sectors of the economy through recurrent recourse to safeguard clauses and/or real exchange rate change, rather than by adopting the appropriate structural or macro-economic policies. This would induce a slowing-down in the process of opening our economies or even a rethinking of some of the steps already taken. Economic agents would be inclined to take full account of the single market in their economic decisions only if they were strongly convinced that the single market is going to last. The perception that the move towards a single market is, indeed, "irreversible" would not be solid without the support of a significant enhancement in the degree of policy co-ordination.

*Revised  
March  
1992*

12. If the conditions exist in which the Single Act can succeed, its implementation will produce additional growth, intra-Community trade and employment for the European Community. The studies evaluating the potential economic effects of completing the internal market have estimated that the additional growth could be equivalent to between 4.5 and 7% of Community GNP and that five million additional jobs could be created.

The European area will then constitute an "optimum monetary area" in which exchange rate stability will be in the interests of each of the parties.

On these bases, and provided that the conditions for convergence exist and without wishing to prejudge the timing, transition to a situation of economic and monetary union would add appreciably to the level and distribution of prosperity in the Community. The risks associated with the elimination of the exchange rate instrument as a means of adjustment will be examined below, but they would be alleviated by the development of common policies and the increased co-ordination of economic policies. On the other hand, the strategies and the behaviour of those involved in economic activity would be served by the elimination of exchange rate uncertainties, the reduction of transaction costs and, perhaps above all, by the perfect transparency of prices which, in itself, should go a long way towards accentuating the gains to be achieved from the internal market.

The common policies, regional and sectoral, of economic union would have powerful redistributive effects, but they would also be conducive to a better allocation of resources by correcting, at Community

level, certain imperfections in the market, for example in the areas of research and development, infrastructure and energy, or the credit rating of public borrowers.

The increased co-ordination of economic policies would be necessary in order to ensure the stability of the system; it would also be beneficial for the member states insofar as it ensured that the increased economic interdependence and the external effects of national economic policies were systematically taken into account and that the reciprocal room for manoeuvre which could be created by a co-operative strategy was used effectively. All in all, therefore, new opportunities would be created for the Community in terms of growth, competitiveness, employment and cohesion.

~~In the interplay of international concertation-European economic and monetary union will also bring a new actor onto the scene whose importance will give it a decisive influence on the management of the world economy and the international monetary system. Exercised in a responsible way, the enhanced Europe's capacity for negotiation and action can make a powerful contribution to the stabilisation and therefore to the growth of the world economy, and this is bound to have induced beneficial effects for growth in Europe.~~

*Community?*  
*substantial*  
*could*  
*a high level of activity in*  
*with*

16. ~~13.~~ Economic and monetary union has been set as a goal by the Community since the late 1960s. The single market, by itself, does not require the establishment of an economic and monetary union. It requires, however, a significant increase in the degree of economic policy co-operation even in areas that are not, as such, part of the single market programme. Such an increase represents a significant progress in the path leading to an economic and monetary union. This is the reason why the European Council in Hannover has decided to consider again the problem of an economic and monetary union and the steps leading to it. These are the subject matters of Parts II and III of this Report.