EUROPEAN ECONOMIC & MONETARY INTEGRATION

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"Free Enterprise was born with man and shall survive as long as man survives".

-A.D. Shroff
1899-1965
Founder-President
Forum of Free Enterprise

EUROPEAN ECONOMIC AND MONETARY INTEGRATION

By

S.L.N. Simha*

What remarkable progress has been made in European economic and monetary integration, solving complex problems through intense and dedicated effort and an unfailing vision of a new united, dynamic, prosperous independent-thinking, powerful, economically and politically, and influential Europe. It is most amazing that many countries which were enemies for centuries, having waged all kinds of wars, small and big, are now building a solid foundation for unity, mutual trust and economic and social progress, and an active, constructive and balanced role in international affairs.

What an utter contrast to the situation in India, where the States cannot agree on matters of mutual interest, big or small, whether it be sharing river water or fixing the boundary of a State or district or tehsil. All that we have are committees, commissions, reports, notes of dissent, walk-outs, morchas, bandhs, rasta roko and riots. We should

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*The author, a renowned economist, was Principal Adviser, Reserve Bank of India. The article appeared in January-March 1999 issue of the Indian Economic Journal, published by Indian Economic Association, and has been reproduced with the kind permission of the author for a wide audience.

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study the progress of European economic and monetary unity, if for no other reason than that of its being a source of inspiration to us to work assiduously for national unity, politically, economically and culturally.

Of course, we must study the European movement for unity, of the last half century, for other reasons too. It will have far-reaching effects on international economic and political relations. What with globalisation efforts in every sphere, India would undoubtedly feel the effects of further progress in European unity, especially the monetary union, with a single currency. As in every other phenomenon, India will have many opportunities and also face problems. It calls for adjustment, adaptation and innovation, all of which require planning, with close collaboration between government on the one hand and industry, trade and finance on the other. How well the government of India is preparing itself for this task is something on which this author has no views, though our general approach to problems is one of tremendous initial enthusiasm and indifference thereafter.

This paper is a brief account of the progress, problems and prospects of European union, especially in the monetary sphere, with a single currency. The material on the subject is vast, far beyond the ability of an old individual economist to grasp fully and convey to the readers the various stages of progress of the European Union movement, in meticulous detail. The object of the note is to give a simple account of the integration process, to stimulate the interest of our young economists in the country to undertake studies of this important movement in Europe, having far-reaching impact globally, as well as on India. It is time that our economists took much interest in economic policy-making, on the solid foundation of economic theory.

A Fifty Year Evolution : European economic and monetary cooperation has a 50-year history, from the time of the U.S. aid to Europe under the Marshall Plan, an important off-shoot of which was the establishment of the European payments Union, to check bilateralism in intra-European transactions. We had then the Organisation of European Economic Cooperation which, later in 1960, was named as Organisation for Economic Cooperation and Development.

In respect of economic integration, one first modest step was the setting up the European Coal and Steel community, in early 1950's. This was followed by steps to facilitate free trade in Europe, leading to the setting of the European Economic Community (EEC), comprising six countries – France, West Germany, the Netherlands, Belgium, Luxemburg and Italy, under the Treaty of Rome of 1957. Under the Treaty, a customs union or common market was to be created and the removal of obstacles to the free movement of goods, services, labour and capital was to be achieved in a period of 12 years.

From a single market, the goal moved towards economic union, with common policies in the fields of agriculture, industry, transport, communications and atomic energy. In due course, the scope of cooperation was widened from that of a single market to cover defence and steps that could lead to political union eventually, so that the European Economic Community became the European Community.

The European Community recently became the European Union, in 1993, comprising economic as well as monetary union, with the ratification of Maastricht Treaty of 1992, the most important Treaty after the Treaty of Rome of 1957. In between the Treaty of Rome and the Maastricht Treaty came the Single European Act, which came into effect on 1st July, 1987, reiterating the need for economic integration, with legal and procedural details, for achieving a full-fledged single market by the end of 1992, by removing all legal obstacles to the free movement of goods, services, capital and labour within the community. By 1995, the membership of the European Community, rose from the original 6 to 15 – the new members being the U.K., Spain, Ireland, Sweden, Greece, Denmark, Finland, Austria and Portugal.

The developments with regard to economic integration, leading to free movement of goods, vehicles and people are too numerous even to be mentioned. Before long, it was realised that monetary integration was also essential for economic integration. In short, monetary union was kept as the goal to be achieved. The European Community members were all members of the International Monetary Fund, which provided scope for monetary cooperation and exchange rate stability. But, the Community members wanted even more stringent rules for exchange rate stability within the Community, through narrowing of the permissible exchange rate movements on either side of the par value, through pursuit of fiscal, monetary and general economic discipline, to produce convergence in these areas rapidly.

The collapse of the Bretton Woods system of U.S. Dollar convertibility to gold for monetary authorities and fixed exchange rates (par value system) in the period 1971-73, caused by the large and persistent external payment deficits of the U.S.A. and later by the oil price shocks, made monetary cooperation among members of the European Community even more necessary, especially to contain movements of exchange rates to narrow limits in relation to one another members' currencies, and stability vis-a-vis the U.S. Dollar too. The arrangements were referred to as `snake in the tunnel' in the beginning; later, the tunnel was given up, on account of joint float of European Community Currencies against the U.S. Dollar, following the general system of floating that came to prevail after the 1973 oil shock.

The snake system did not work well, for a number of reasons, including frequent entry and exit of member countries and many revaluations and devaluations of European Community currencies. There was often conflict between regional and global interests. The system was also considered to be rigid.

European Monetary System : In the circumstances, the European Community took a decision in 1978 December to set up the European Monetary System (EMS), with effect from 1st March 1979. Its four elements were (1) The European Currency Unit (ECU), (2) The Exchange Rate Mechanism (ERM), (3) The European Monetary Cooperation Fund (EMCF) and (4) The Very Short-term Financing Facility (VSTF).

The ECU is a basket of 12 member countries; earlier it was an open basket but from November 1993, it has been a closed one. The ERM may be said to be a modified form of the snake system, with a central rate for each ERM currency against other currencies, with freedom to move 2.5 per cent on either side of the central rate.

Although the EMS's performance was like that of the curate's egg, on the whole there was progress towards monetary stability. It was considered, in 1988, that the stage was ripe for taking further steps towards a full-fledged monetary union. For this purpose, a Committee was appointed under the Charimanship of Mr. Jacques Delors, President of the European Commission, with the Governors of all central banks of the Community as members. There were also a few outside experts as members.

The unanimous report of the committee was ready in April 1989.

Delors Committee Report : The Report was a far-reaching document, the two most important recommendations being the introduction of a single currency for the European Community and the establishment of the European Central Bank, as the prime monetary authority, the central banks of member states being a part of the European System of Central Banks. The Committee envisaged progress towards full union in three stages (1) consolidation of single market of goods, services and capital, with removal of barriers, especially on movements of capital, (2) revision of existing institutions of the community and setting up of new ones, further progress towards fiscal and monetary convergence among members and prescribing criteria for membership of the single currency and (3) fixation of exchange rates of members irrevocably, for exchange into the single currency, and then the introduction of the currency itself.

For implementing the recommendations of the Delors Committee, and in particular to fill in various details of the proposals, for stage III, when the single European currency was to be introduced, a new major Act was required. This was done in February 1992 at Maastricht, the Netherlands, and the Treaty was ratified in 1993. The European Community then became the European Union.

Before going into the important provisions of the Maastricht Treaty, let us mention at this stage itself that 11 of the 15 members of the European Union have joined the single currency system (Euro), which has come into effect from 1st January 1999. The four countries not joining the Euro club now are the U.K., Sweden, Denmark and Greece. The period 1993-99 constitutes stage II of the monetary union, during which institutional arrangements are to be completed for the launch of the Euro and member countries take steps to achieve conference in various economic and financial policies and results to satisfy the criteria for joining the single currency system.

It should be noted that the fundamental objective of monetary union is to ensure stability-price stability and exchange rate stability which, experience has shown, are vital for economic growth and employment creation. So, fiscal and monetary policies have to be geared to secure stability. On the fiscal side, the main endeavour has to be to keep public sector budget deficit to a low figure, in relation to the gross domestic product and likewise, outstanding public debt should remain low. On the monetary side, action lies in using various instruments – open market operations, discount rate, statutory reserve requirements etc. when signals such as money supply growth, and market movements of exchange rates and interest rates, so indicated.

It was essential to make much progress in fiscal and monetary areas before stage III of monetary union commenced. So, a series of policy measures were initiated by the European Community, including institutional arrangements, such as :

1. Fixation of fiscal criteria – the public sector budget deficit should not exceed 3 per cent of GDP and outstanding public debt should not exceed 60 per cent of GDP.

2. An European Central Bank (ECB) was to be set up, for the European Union. This institution together with the various central banks of member countries constitutes the European System of Central Banks (ESCB). The Maastricht Treaty has made elaborate provision for the independence, from political control, of the ECB. However, it remains to be seen how this will work in practice, having regard to general economic objectives, with potential for Government interference and conflict between the central bank and Government. To prepare for the establishment of the ECB, an interim arrangement was made by means of the establishment of the European Monetary Institute, in 1994, from which date it may be said that Stage II of the monetary union commenced. It may be mentioned here that the European Central Bank started functioning from 1st July, 1998.

3. To highlight the importance of stability, especially fiscal stability, a formal pact was concluded in

1997, especially at the instance of Germany, which has been a staunch advocate *and* practitioner too, of this objective in the Post-War II years. It was to be called stability pact, but later, as a sop to the views of some other member states, it was named as pact for stability and growth, although it has always been understood that stability is meant for securing growth. The Pact prescribed fines for violation of the code of fiscal and monetary discipline.

4. Decision was taken in 1995 to name the single currency for Europe as EURO. The date for the commencement of the Euro system was fixed for 1st January, 1999. The printing of Euro bank notes and the minting of coins has commenced. The full-fledged operation of Euro will start from 1st January, 2002. By that date, the change-over of the banking system to Euro should be completed. The legal tender character of the national currencies will also go by July 2002.

The Euro, unlike the earlier European Currency Unit (ECU), will not be a basket of currencies. It will exist and function as an independent currency, in its own right, with requisite assets to match the issue of Euro by the ECB, in accordance with the provisions of the Maastricht Treaty, like the position with regard to national currencies.

Evolution of European Monetary Unit : It may be useful to give a very brief account of the evolution of a single currency for Europe, the beginnings of which go back to 1973, after the second devaluation of the U.S. dollar, in terms of gold, and later the breakdown of the Bretton Woods fixed exchange rates system based on gold/dollar. The first of the series was the creation of the European Monetary Unit of Account (EMUA), declared to be equal to pre-Smithsonian gold content of the U.S. Dollar, namely, 0.88867088 gram of fine gold. The EMUA was used as a numeraire by the European Cooperation Monetary Fund and the European central banks participating in the "snake" exchange rate arrangement, referred to earlier.

As it became increasingly clear that there was no likelihood, in the forseeable future, of the return to the old system with fixed link to gold/Dollar the European Community took steps to delink their monetary unit of account to gold. The new unit, the European Unit of Account, was created in April 1975. It was declared to be a basket of currencies of the nine members of the European Community. Besides the two purposes mentioned in the previous paragraph, the EUA was to be used as a numeraire, for the European Development Fund, the European Investment Bank, the European Coal and Steel Community and the European Community for its general budget and customs matters.

The EUA was to be the basket of all the nine members of the European community, with specified weights for each currency. The weight varied from

0.3 per cent for the Luxemburg Franc to 27.3 per cent for the Deutsche Mark. The *Quantities* of each currency in the basket was on the basis that the aggregate value of the basket of currencies, as of a particular day or a particular 3-month period (28th March-June 27, 1974, was selected), was to be equal to one Special Drawing Right of the International Monetary Fund. Later the EUA was to evolve on its own.

It was mentioned earlier that when the European Monetary System was set up in March 1979, one of its main features was the creation of the European Currency Unit (ECU), again as a unit of account, and also a basket of currencies. On the transition day, that is, the 12th March 1979, the value of ECU was to be equal to that of EUA. Provision was made for a periodic review and change in the composition of the ECU basket of currencies. Since the creation of the ECU in March 1979, there have been two revisions, in September 1984, when the Greek currency was introduced to the ECU basket and again in September 1989, when the currencies of Spain and Portugal came to be included in the basket. No revision of the composition of the basket has been made since September 1989. No change was permissible after the Maastricht Treaty came into force in 1993.

It should be mentioned that the ECU has been not only a unit of account but also as an official reserve asset for settlement among monetary authorities of the Members of the Community/Union. The European Monetary Fund gives ECUs in exchange for gold and U.S. Dollars. It should be noted that in this regard, the ECU arrangement, which comprises a basket of currencies of member countries, is different from the Special Drawing Rights of the IMF, which are issued to member countries without any exchange. However, a country can use SDRs only by exchanging them for currencies of member countries and it has to pay interest to the IMF, since the exchange is in effect borrowing ("drawing", in the terminology of the IMF). It is beyond the scope of this paper to go into further details of the relative features of the ECU and the SDR.

In preparation for the arrival of a truly single currency, the ECU has been used to some extent, by international institutions, supra-national institutions and agencies, sovereign governments as well as by the private sector, by issuing ECU – denominated debt instruments – bills, bonds, etc. The non-private issuers of ECU–denominated securities include the World Bank, the European Investment Bank, the Council of Europe, Member states such as France, Greece, Italy, Portugal, Spain and the United Kindgom and the non-EU governments such as New Zealand.

It has also been the practice for some commercial banks to accept deposits, issue certificates of deposit and grant loans denominated in ECUs. Commercial banks also carry some ECU deposit accounts opened by central banks. ECUs are also used by multinationals for intra-group settlements. The ECU is also being used by large companies to present their annual accounts, besides the respective national currencies. For several years now, the ECUs are also used by the European Community/Union for some budgetary transactions.

All this indicates that much earnest effort is being made to bring about a smooth transition from a system of several European Currencies to a single currency. This is a tribute to the leadership of the executives of the European Community/Union and the member governments, for the foresight, advance planning and hard work they have put in, in implementing the plans. There will be further progress in the matter after 1st January, 1999, when the single currency system came into force, though actual circulation of ECU currency notes and coins will commence only in 2002.

Action was also taken towards the end of 1998 to fix, *irrevocably,* the exchange rates of eleven Euro member currencies for purposes of conversion into EURO. These rates are, for every EURO : 1.95583 German Marks; 6.55957 French Francs; 1936.27 Italian Lira; 40.3399 Belgian or Luxemburg Francs; 2.20371 Dutch Guilders; 166.386 Spanish Presta; 200.482 Portuguese Escudos; 13.7603 Austrian Schillings; 0.787567 Irish Punts; 5.94573 Finnish Marks.

Independence of ECB and ESCB : It will be instructive to note, very briefly, the provisions, in the Maastricht Treaty, officially known as Treaty on European Union, to ensure the independence of the national central banks and the European Central Bank, for achieving the economic and social objectives of the European Union, mentioned in Article 2, as under:

> The Community shall have as its task, by establishing a common market and an economic and monetary union and by implementing the common policies or activities referred to in Article 3 and 3a, to promote throughout the Community a harmonious and balanced development of economic activities, sustainable and non-inflationary growth respecting the environment, a high degree of convergence of economic performance, a high level of employment and of social protection, the raising of the standard of living and quality of life, and economic and social cohesion and solidarity among member states.

A very important indicator of a central bank's independence is the extent to which it restricts its credit to government, an aspect where the performance of most central banks, especially in the developing countries, is very disappointing, this being the principal contributory factor of inflation. In such a background, Article 104 of the Treaty will be read with interest.

1. Overdraft facilities or any other type of credit facility with ECB or with the national central banks of the member states (hereinafter referred to as `national central banks') in favour of Community institutions or bodies, central governments, regional local or other public authorities, other bodies governed by public law, or public undertakings or member states shall be prohibited as shall the purchase directly from them by the ECB or national central banks of debt instruments.

2. The provisions of paragraph 1 shall not apply to publicly-owned credit institutions, which in the context of the supply of reserves by central banks shall be given the same treatment by national central banks and the ECB as private credit institutions.

A complementary clause, 104 c, deals with government budget deficits and government debt, as under:

1. Member states shall avoid excessive government deficits.

2. The Commission shall monitor the development of the budgetary situation and of the stock of government debt in the member states with a view to identifying gross errors. In particular it shall examine compliance with the budgetary discipline on the basis of the following two criterias:

a. whether the ratio of the planned or actual government deficit to gross domestic product exceeds a reference value.

b. whether the ratio of government debt to gross domestic product exceeds a reference value, unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace.

The reference values are specified in the protocol on the excessive deficit procedure annexed to this Treaty. This has been mentioned earlier, namely, 3 per cent and 60 per cent, respectively.

The importance of price stability is stressed as the guiding principle for the new European System of Central banks, in article 105.

The primary objective of the ESCB shall be to maintain price stability. Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Community as laid down in Article 2. The ESCB shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 3a.

The independence of the central banking system is sought to be safeguarded by Articles 107 and 108, as under :

> **Article 107** : When exercising the powers and carrying out the tasks and duties conferred upon them by this Treaty and the Statute of the ESCB, neither the ECB, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Community institutions or bodies, from any government of a member state or from any other body. The Community institutions and bodies and the governments of the member states undertake to respect this principle and not to seek to influence the members of the decision-making bodies of the EDB or of the national central banks in the performance of their tasks.
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> **Article 108** : Each member state shall ensure, at the latest at the date of establishment of the ESCB, that its national legislation including the statutes of its national central bank is compatible with this Treaty and the Statute of the ESCB.

The Governing Council of the ECB comprises the members of the Executive Board of the ECB and the Governors of the national central banks.The Executive Board comprises the President, the Vice-President and four other members, for a non-renewable term of eight years. The procedure for appointing the Executive Board is such as to secure full political backing. The members of the ECB are to be appointed "by common accord" of the governments of the member states at the level of Heads of State or of government, on a recommendation from the (European) Council, after is has consulted the European Parliament and the Governing Council of the ECB.

Provision has also been made for the independence of the national central banks, which have to function, naturally, under the guidance of the ECB. To ensure this, the statutes of national central banks were required to be amended to achieve the above purpose. The statutory provisions are contained in Article 14 of the *Protocol.*

> 14.1 In accordance with Article 108 of this Treaty, each member state shall ensure, at the latest at the date of the establishment of the ESCB, that is national legislation, including the statutes of its national central bank, is compatible with this Treaty and this Statute.
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> 14.2 The statutes of the national central banks shall, in particular, provide that the term of office of a Governor of a national central bank, shall be not less than 5 years.
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> A Governor may be relieved from office only if he no longer fulfills the conditions required for the performance of his duties or if he has been guilty of serious misconduct. A decision to this effect may be referred to the Court of Justice by the Governor concerned or the Governing

Council on grounds of infringement of this Treaty or of any rule of law relating to its application. Such proceedings shall be instituted within two months of the publication of the decision or of its notification to the plaintiff or, in the absence thereof, of the day on which it came to the knowledge of the latter, as the case may be.

14.3 The national central banks are an integral part of the ESCB and shall act in accordance with the guidelines and instructions of the ECB. The Governing Council shall take the necessary steps to ensure compliance with the guidelines and instructions of the ECB, and shall require that any necessary information be given to it.

Institutions of the Union : Before we conclude, it would be interesting to note very briefly the institutional machinery of the European Union, besides the central banking arrangements referred to above. There are five institutions, namely, the European Commission, the Council, the European Parliament, the Court of Justice and the Court of Auditors.

The *Commission* comprises 20 members, appointed for a period of five years, by common agreement – 2 each from France, Germany, Italy, Spain and the U.K., and one each by the remaining ten members. One member is appointed as President.

The Commission's appointment is subject to the approval of the European Parliament.

The *Commission* may be considered to be the executive branch of the Union, ensuring the smooth compliance of the various Treaties. There is a civil service to support the Commission, located principally in Brussels.

The *Council* comprises 15 members, one each representing the member countries. The Presidentship rotates every six months. It is the principal decision-making authority of the Union. There is also an *European Council* composed of the heads of State or Government.

The European *Parliament* comprises 626 members, who are elected once in five years, by direct universal suffrage. By the European Union Treaty of 1992, the Pariliament is given legislative powers on matters that come under the purview of the union.

The *Court of Justice* comprises 15 judges, with responsibility for the implementation of the various Treaties of the Union. The judges are appointed by agreement among member governments, for six-year terms. The *Court of Auditors,* also comprising 15 members, is to ensure that revenue and expenditure are in conformity with the laws of the Union.

Problems and Prospects : From the above pages, it is clear that tremendous progress has been made towards European economic and monetary Union, with foundation laid for broad cooperation and coordination in other areas too. The record of cooperation is very good so far. However, hundreds of questions, queries, doubts and even fears have been expressed about the success of the monetary union, with a single currency. True, ever so many operational problems have to be solved, about the functioning of the ECB, the status of the national central banks, coordination of policies between the above two, exchange rate management and relations with the IMF. More progress is called for in fiscal and monetary convergence. People in general, industry, trade and banking, in particular, have to make tremendous adjustments and adaptations. What was foreign becomes domestic. All these have important political aspects, casting legitimate doubts as to how far the ECB can be truly independent, free from political influence and intervention.

At the very outset, politics crept in, when the President of the ECB had to be appointed. France was very keen that the job should go to a Frenchman. A compromise was worked out, whereby the selected candidate, a Dutch national, would relinquish the post after half the term of eight years is over, making way for the French government's nominee, its national, now a member of the Executive Board of the ECB. There are also doubts whether, in the context of serious unemployment, anti-inflationary objective should be of paramount importance for the Union, and even otherwise, whether monetary and economic objectives can be achieved without trade-offs.

Clearly, the ECB is to have influence over fiscal policies of the member states, if the objective of stability with growth has to be achieved. But to what extent individual member countries can and will surrender their responsibilities in economic matters to ECB and other organs of the Union, remains to be seen.

There will also be problems between those member countries of the Union who have joined the single currency system and those who have not. If the European Union has to be stable, the other members will also have to join or leave the Union altogether. There are also problems connected with many applications for membership. The decisions on these are expected to take 3-5 years.

What all this means is that the next several years will be one of stresses and strains for the European Union. Problems will have to be solved by political will and cooperation. It should be noted that the whole movement of economic and monetary integration has been as much political as economic; nay, the political aspect has been the chief motivating factor, as Mr. Delors himself said in his C.D. Deshmukh Memorial Lecture in New Delhi, a couple of years back. In fact, the logical step and practical too, is to start in earnest political union, even if one has to have a long-term time-frame of 40-50 years to achieve this. Say, it will take a hundred years; it is still fine, if one looks back at European history of the last 1000 years. Let us remember that it has taken more than 40 years to reach the present position in European economic and monetary cooperation. Let the progress be slow, very slow, but let there be forward movement.

What if it is found later that things have gone too far in the matter of integration and some reversing is called for? If this were to happen at all, there should be no loss of prestige. But why worry now? Why should confidence be lost at the very outset? The indications are that there is continued earnestness about taking European cooperation to new dimensions. All that may happen is that progress in implementing fully the monetary union decisions may be slower than anticipated. Let it be so. In matters concerning 15-20 sovereign states, it is unwise to expect fast progress. There should be no bulldozing in this matter, for that matter in any national or international policy. It should be noted that when the IMF and the World Bank were being set up in 1944-45, there was large-scale scepticism, cynicism and even certainty of failure. The two institutions have not done badly. International financial cooperation has been well established; now and then reform has been carried out. This is a continuing process.

What has been achieved thus far in European economic and monetary cooperation is stupendous by any standard. The economists have put in a lot of excellent effort to work out the details, but the grand performance so far is mainly the work of great political leaders. Economists, and *The Economist* too, may criticise, doubt and despair, but Europe is bound to produce leaders of ability, enthusiasm and determination, to carry forward the goal of economic and financial union.

The economic and monetary union should strengthen the European economy, make it more efficient and competitive and enlarge national output. A politically, economically, financially strong Europe is a great bulwark against excessive domination of one country, the USA, especially after the disintegration of the USSR. In fact, keeping the balance of power in world affairs was the dominant reason for the launching of the European unity movement by great political leaders of France and Germany, De Gaulle and Adenaur in particular, in fifties. That consideration has much stronger force today. No nation can produce exceptionally great leaders every now and then. They are a rare species, as we have found in India. But even not so great leaders can produce good results, with faith, dedication and effort. In this matter, this author for one has restrained optimism, without which life itself becomes boring, unproductive and intolerable.

At this stage, it is difficult to be dogmatic about the role of the Euro as an international reserve currency, whether it will overtake the US Dollar before long, and how stable the Euro will be vis-a-vis the US Dollar and the Japanese Yen. Having created the Euro afer many years of debate and experience, one should be optimistic that every effort will be made to make it strong, since the focus of the Maastricht Treaty is on the maintenance of price and exchange stability. Macroeconomic policies, it should be hoped, will be used appropriately towards this end.

There will inevitably be some indecision, hesitation, and experimentation during the transition period, which may be as long as 5-10 years. It should be hoped that the other developed countries, in particular the USA and Japan, and the international Monetary Fund, would offer appropriate cooperation to help the new currency to attain strength and stability, to the extent that such cooperation offers scope for this, in their mutual interest. The international monetary cooperation and consultancy processes should become simpler, since now a single authority will speak, by and large, in place of several countries as hither to, even if the members of the European Union prefer to keep their individual membership of the IMF.

We may conclude this paper with the following extracts from the speech of Mr. Michel Camdessus, Managing Director of the IMF, at a conference on the implications of European Economic and Monetary Union (EMU), in Washington D.C. on 18th March, 1997.

> "The EMU holds out the promise of a strong new pillar for the world monetary system. A common currency will lower transaction

costs, reduce exchange risks, stimulate competition and facilitate the broadening and deepening of European financial markets. It will also cement a larger economic space better able to face external challenges, be more impervious to external shocks.

At this point it is very difficult to predict justly how the Euro will fit into the constellation of other reserve currencies. However we can safely assume that its position will depend largely on the strength of its domestic foundations – that is, on the continued macroeconomic convergence of its member countries, the pace of structural reform, the depth and breadth of euro-denominated financial markets, and the degree of political cohesion among EMU members on key policy issues.

The IMF has learned a lot since 1978 (the inception of the European Monetary System). We have learned how to recognise misalignment; how to correct them and what to imply in terms of international dialogue and cooperation. Thus, we are equipping ourselves to play the role we could be called upon to carry out.

I have no doubt that we will enjoy the full cooperation of the European authorities in developing a constructive dialogue on the potentially difficult issues we may face. Concentrating early enough, and openly enough, on these issues, with the technical support of our professional staff and the contribution of all its members, will be essential in ensuring that EMU and the Euro achieve their full potential".

The experience of the first few months of 1999 is very encouraging, with regard to the strength and popularity of the *Euro*. It has been commanding a small premium in relation to the U.S. Dollar, though the premium declined from the initial rate $1.16 to the Dollar. There has been a substantial amount issue of bonds designated in the *Euro*. It has been reported that as many as 13 million *Euro* bank accounts were opened in the first few months of the year.

Ultimately, the strength of the *Euro* depends upon the growth and stability of the countries which have joined the single currency system, and their macro economic policies. One should remain optimistic in this regard. We must also assume that there will be substantial economic and financial cooperation between Europe and the U.S.A. for stability and efficiency of the international monetary system, along with other countries, in particular Japan.

The views expressed in this booklet are not necessarily those of the Forum of Free Enterprise.

"People must come to accept private enterprise not as a necessary evil, but as an affirmative good".

-Eugene Black

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FORUM OF FREE ENTERPRISE

The Forum of Free Enterprise is a non-political and non-partisan organisation started in 1956, to educate public opinion in India on free enterprise and its close relationship with the democratic way of life. The Forum seeks to stimulate public thinking on vital economic problems of the day through booklets and leaflets, meetings, essay competitions and other means as befit a democratic society.

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Write for further particulars (state whether Membership or Student Associateship) to the Secretary, Forum of Free Enterprise, "Peninsula House" (Formerly Piramal Mansion), 2nd Floor, 235, Dr. Dadabhai Naoroji Road, Post Box No.209, Mumbai 400 001.

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