European Economic and Monetary Union

- principles and perspectives

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The European integration process started shortly after the Second World War and was, at the time, strongly motivated by political factors. The aim was to eliminate the risk that wars and crises would once more plague the continent. The first concrete result was the establishment, in 1952, of the European Coal and Steel Community between six countries (Belgium, France, Germany, Italy, Luxembourg and the Netherlands). This was followed by the adoption of the Treaty of Rome in 1957, laying the foundations for the European Economic Community.

The first concrete proposal for a Monetary Union was presented in the so-called Werner Report in 1970. The Report was intended to pave the way for the establishment of a Monetary Union in the early 1980s. However, the proposals of the Werner Report were never implemented - being overtaken by world events. After the break-up of the Bretton Woods system and the shock of the first oil crisis in 1973, most western European economies were contaminated by the economic sickness popularly labelled "Eurosclerosis", characterised by high inflation and persisting unemployment. At that time, the European economies were protected by regulations and financial markets were still poorly developed. In this environment, it was concluded that a Monetary Union would not be possible and the project was postponed.

The idea of establishing Monetary Union was revived only in 1988 and a detailed proposal was presented the following year in the Delors Report, after the launch (in 1985) of the Single Market programme on the free movement of goods, services, capital and labour. Because of the single market, the Report could be more explicit and credible with regard to how best to achieve closer economic ties between the EU economies before the introduction of a single currency. Moreover, the Report was supported by a detailed description of an institutional set-up geared towards ensuring stability-oriented economic policies.

Notwithstanding the thorough work invested in the Delors Report, almost 10 years of convergence and technical preparations were required in order to ensure the successful implementation of the euro on 1 January 1999. And the project is still not over: the euro coins and banknotes will be introduced only in 2002 - 13 years after the presentation of the Delors Report and 32 years after the presentation of the Werner Report.

Achieving a credible currency

Today, almost two months after the introduction of the euro, we can say that the technical changeover to the euro was successful. Now, the Eurosystem (i.e. the ECB and the 11 national central banks of the participating Member States) must focus on ensuring the long-term success of the new currency. The credibility of a currency is built up by several factors, the basis of which is the central bank's commitment to price stability. Here, the Eurosystem is in the fortunate position of being assigned, through the Maastricht Treaty, the unambiguous primary objective of maintaining price stability in the euro area.

Another fundamental building block of credibility is ensuring that monetary policy decisions are independent of political pressures. This building block was also laid dov Maastricht Treaty, which ensures that the ECB and the participating national cent enjoy a very high degree of independence, possibly more than any other central ba world.

The credibility of a currency also relies on the preparedness of governments t stability-oriented policies of fiscal discipline and to undertake necessary structural On this point, the Stability and Growth Pact adopted by the EU countries provide framework for fiscal discipline and should enhance the governments' incentive to pro structural reforms.

In order to enhance credibility, it is also important that the central bank's str achieving the primary objective is clear and that the link between the strategy and tl bank's policy actions is easily understood by the public. By following a transparent a the central bank can directly improve the efficiency of monetary policy. This cont achieving stable prices with the lowest possible interest rates.

Striving towards increased transparency led the Governing Council of the ECB (con the Governors of the 11 national central banks and the six members of the ECB's I Board) to establish a precise definition of price stability in order to bring about absolu as regards the primary objective; price stability was defined as a year-on-year increa Harmonised Index of Consumer Prices (HICP) for the euro area of below 2%. medium-term objective. In the short run, many factors beyond the scope of moneta also affect the price movements.

The adoption of the Eurosystem's monetary policy strategy also aimed at e transparency in the implementation of monetary policy. The strategy is based or elements: First, money has been assigned a prominent role in the form of a reference the growth of the euro area wide monetary aggregate M3. Second, the Eurosystem c a broadly based assessment of the outlook for price developments and the risks stability in the euro area on the basis of a wide range of economic and financial ind

In order to explain to the public the Eurosystem's policy actions against the backgrou adopted monetary policy strategy, the Eurosystem uses several channels: the ECB's Bulletin; the issuance of a detailed press release after each Governing Council m which the decisions are explained; the organisation of a monthly press conference at the appearances of the President at the European Parliament; and, finally, the r speeches and articles by the members of the Governing Council. Taken as a w Eurosystem is probably among the more active central banks when it comes to expl policies to the public.

A further important building block in order to establish credibility is the promot efficient implementation of the monetary policy decisions. The Eurosystem has air up an operational framework which is consistent with market principles and whic equal treatment of counterparties and financial systems across the euro area. The Eur operational framework is based on the principle of decentralisation in order to take a of the established links between the national central banks and their counterpar monetary policy operations will therefore be conducted by the national central bar decisions are taken centrally in the ECB's decision-making bodies.

The consequences of a single currency: perspectives for the futur

The most important effects of the single currency relate to the possibility of i macroeconomic stability and credibility for the policies pursued; these effects are pa important for the smaller European economies. Moreover, important benefits can b from microeconomic factors, such as lower transaction costs, wider and deeper financial markets, improved price transparency and increased competition.

Starting with the macroeconomic factors, Monetary Union makes it possible for the participating countries to combine their credibility. In this way, small countries can, to a certain extent, "borrow" credibility from some of the large countries which have pursued stability-oriented policies for a long time. Under credible conditions, the financial markets are no longer under pressure from speculative attacks by large institutional investors. Price and interest rate developments are stabilised, and the investment climate for companies is secured. In the microeconomic field, the most obvious consequences relate to lower transaction costs and increased price transparency across national borders. These factors are likely to contribute to increased competition and downward price pressure on many products.

One very important consequence is that the use of a single currency will give rise to larger and more competitive financial markets in the euro area. In most European countries, the financial markets have, by tradition, been rather shallow, with few participants and a rather narrow set of financial instruments on offer. A high degree of segmentation and a lack of cross-border competition have implied relatively low trading volumes, high transaction costs and a reluctance to implement innovative financial instruments.

On the introduction of the euro, the foreign exchange risk of trading in the different national markets in the euro area fully disappeared. This has triggered increasing cross-border competition and has provided an incentive for the harmonisation of market practices. In fact, the trading of money market paper and euro area government bonds can already be considered to be largely integrated. The markets for private bonds are still segmented owing to the differing institutional and regulatory conditions across Member States, but they, too, will gradually integrate and provide an incentive for increasing the issuance volumes of private bonds. This will contribute to reducing the financing costs for private companies, and it will provide improved opportunities for investors.

Monetary Union provides much needed assurance of exchange rate stability for exporters, importers and investors. This is particularly important for small and open economies. In fact, most countries in Europe are to be considered small in the current global perspective. The active use of the exchange rate as a tool of economic policy could be an alternative for a large reserve-currency country. For a small country, experience has shown that large changes in the exchange rate tend to give rise to higher costs rather than benefits, due to the harmful effects on expectations and higher interest rates.

Some of the economic effects of the Monetary Union may partially benefit also the countries remaining outside Monetary Union. Nevertheless, it is important for the "out" countries, to assess whether they find that the benefits of maintaining a national monetary policy "autonomy" - if there is any such autonomy in an integrated and globalised market situation - outweigh the possible drawbacks of not being able to fully draw on the credibility of the euro area, the integration of the euro area financial markets, lower transaction costs, improved price transparency and increased competition.

The euro and the Nordic countries

The Nordic countries have chosen to organise their monetary policy ties to the euro area in very different ways: Finland is the only Nordic country taking part in Monetary Union as from the start of Stage Three; Denmark negotiated an opt-out from Monetary Union but follows a fixed exchange rate policy vis-à-vis the euro within the new Exchange Rate Mechanism (ERM II); Sweden decided not to participate in Monetary Union from the start of Stage Three, without having a formal opt-out and the Swedish krona still floats freely against the euro; and Norway and Iceland remain outside the EU altogether.

The divergent approaches taken by the Nordic countries as regards one of the most i economic and political projects in Europe in modern times are somewhat strange i their traditionally close cultural, historical, political and economic ties. Nordic co- has always been very important and close. I note with satisfaction that the public op Denmark and Sweden now seem to be swinging in a more favourable direction with future membership. Maybe the successful implementation of the euro has made t understand that Monetary Union is aimed at ensuring long-term stability in Europ context, the recent signals from the Government of the United Kingdom in t membership in the Monetary Union are also very encouraging.

Personally, I think that it would be beneficial to all Nordic countries - and th Kingdom - to join Monetary Union within the not too distant future. I hope that Sw Denmark can become members already before the introduction of the euro bankn coins in 2002.

It is important for these countries to also assess the political aspects of remainin Monetary Union. Experience has shown that EU Member States which have taken i and worked constructively towards European integration have been generally more s in gaining influence than those less committed to the project. In this respect, it should that the aim of the Maastricht Treaty is clearly to establish a Monetary Union comp EU Member States.

Personally, I also think that the Nordic countries could provide a fruitful joint contr the long-term success of Monetary Union. There is no need to overemphasise the role countries in this process, but it is clear that co-ordinated views by a group of small would have a larger influence than the views of individual countries. One of the b the Nordic countries - and small countries in general - is that they are seldom boun old traditional system. In contrast, they typically fight for efficient solutions which in the interest of the whole of the euro area.

Concluding remarks

The project to establish European Economic and Monetary Union was carefully prep based on very strong political commitment. It has contributed to the co-ordination of policies - even in a wider sense - in an environment of deregulated financial marke free flow of capital. The stability arguments behind the introduction of the euro hav well accepted that we are already seeing serious and visible efforts aimed at the towards a global "single currency" through the establishment of exchange rate co-o between the euro, the US dollar and the Japanese yen. In order for any such w currency co-ordination to become successful, there would be a need for political com to globally harmonising fiscal, monetary and structural policies. In this context, I wou realism, caution and a gradual approach in spite of the longer-term ideal goal stability. There are still many challenges and adjustments ahead within the euro ar any world-wide steps should be considered. Our first priority is to ensure long-term in the euro area economies under the single monetary policy and on the hope that the will soon cover all EU countries.

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