

## **EDITORIAL COMMENTS**

### **The birth of the Euro**

These editorial comments are written during the weekend of 1 and 2 May 1998 which saw the birth of the Euro. It is an historic occasion. It represents the next concrete step towards European integration. In the logic of the evolutionary development of the European construction, it builds on the internal market, and brings us closer to the “ever closer union” envisaged by the Treaty-makers, and perhaps even towards the final step of political integration, however modest that may turn out to be.

1. As ever with the Community, the final stages were convulsive. The dispute over the appointment of the President of the European Central Bank (ECB) was typical of the arcane decision-making processes of the old Community. We are told that this was not an argument over personalities - both candidates were central bankers with much the same views on a disciplined monetary policy and price stability. Likewise, it was apparently not so much a dispute between France and Germany, but a wish on the part of the former to see installed a President who might perhaps be more attentive to the social consequences of monetary policy, including unemployment. At the same time, it was apparently a conflict over the right of the politicians to make a political choice to appoint an ECB President rather than to accept a candidate favoured by the majority of the governors of the Central Banks of the Member States. Whatever the reasons for this dispute, one thing is clear. From the point of view of the citizen, it seemed to be a conflict over national pride. Citizens expecting a smooth transition can be forgiven for being disappointed that on this historic weekend, the Member States failed to seize the opportunity to celebrate this extra-

ordinary step and to convince the numerous citizens in many Member States who still harbour doubts over the wisdom of the whole enterprise. This then was a lost opportunity.

The legal implications of the choice finally made<sup>1</sup> are preoccupying. According to Article 112 (ex Article 109a) of the Treaty,<sup>2</sup> in conjunction with Article 50 of the Protocol on the Statute of the European System of Central Banks and of the European Central Bank, the first President of the Bank is chosen by common accord of the governments of the Member States, on a recommendation from the Council, after it has consulted the European Parliament and the Council of the EMI. The Council recommendation of 2 May 1998 designating a President for a mandate of eight years will thus have to be presented to the European Parliament. The Parliament will have to consider whether the reported verbal undertaking given by the designated President of the ECB to step aside before the expiry of his term (and which has been taken to indicate that he will in fact resign between January and June 2002) is actually the case, and if so, whether it approves of this. The Parliament has already made clear its disapproval of a split mandate, but this reported solution is something more subtle, as it does not directly contravene the time-limit of the mandate of eight years laid down by Article 112 (ex Article 109a) but certainly goes against the spirit of that provision.

It should be borne in mind that the reason for the 8 year non-renewable mandate is to provide for the independence of the members of the ECB Executive Board, and a fortiori, of its President, reflecting the emphasis on the independence of the ECB required by Article 108 (ex Article 107) and in Article 9 of the Protocol. It should also be recalled that the Maastricht Treaty, including the provisions relating to its independence and the mandate of the President of the ECB, has been approved in many Member States by referenda and in all Member States by national parliaments in accordance with national con-

1. Council Recommendation of 2 May 1998 on the appointments of the President, the Vice-President and the other members of the Executive Board of the European Central Bank, to be published in the Official Journal.

2. In these comments, we use the numbering of the new consolidated version of the EC Treaty.

stitutional requirements; the informal outcome regarding the term of the President is an extraordinary example of a Community institution effectively side-stepping if not actually over-turning a democratically approved decision. It will be up to the European Parliament to decide whether to accept this state of affairs or not by registering a vote of dissent. Indeed in a Community where the democratic deficit seems to increase rather than diminish, the Parliament is solely legitimate to make this judgment at the Community level. Unfortunately, however, it does not appear that its views are binding. The Council of the EMI as a whole is unlikely to diverge from the recommendations made by the Council.

It should nevertheless be recalled that national central banks, in particular those of Germany and The Netherlands, are still capable of influencing opinion in their respective Member States. A statement by the *Bundesbank* which condemned this alleged arrangement would pose notable difficulties for the German Government. It is also possible that there may be a challenge before the German Courts or, less likely, before the European Court of Justice. The markets will no doubt give their views on what this last-minute (but well-heralded) struggle will mean in terms of stability of the Euro as a currency, and for the independence of the ECB Executive Board from the Member States in carrying out its primary task of ensuring price stability. Rightly or wrongly, they will also decide whether the ECB starts with a lame-duck President.

2. Apart from these teething troubles, which after all are relatively unsurprising to anyone familiar with the Community, much was achieved in this historic weekend. The Council Decision of 2 May, meeting in the composition of Heads of State or Government, taken in accordance with Article 121 (ex Article 109j(4)) carried out an examination of whether the different Member States fulfilled the necessary conditions for the adoption of the single currency on the basis of recommendations from the ECOFIN Council of 1 May 1998. Of these, the excessive government deficit criterion, the conditions relating to Exchange Rate Mechanism (ERM) stability and the independence of the national central banks deserve attention.

(i) *Excessive government deficit.* The ECOFIN Council and the Council in the composition of Heads of State or Government took a particularly magnanimous view of the public debt situations of the countries admitted to participate in the third stage, although it should be recalled that according to Article 104(2)(b) (ex Article 104c), there is room for flexibility where the ratio of government debt to GDP exceeds a reference value, if the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace.

In the case of Belgium and Italy, both of which have public deficits about twice the Maastricht reference value, the question of the excessive government deficit criterion set out in Article 104 (ex Article 104c) was dealt with by simply stating that neither country was the subject of a Council decision on the existence of an excessive government deficit. In the case of Greece, it was noted that the Council had decided on 26 September 1994 that an excessive government deficit exists in Greece and that this Decision had not been abrogated. This formal approach finds its roots in Article 2 of the Protocol on the Convergence Criteria Referred to in Article 109j, annexed to the EC Treaty, "the criterion on the government budgetary position . . . shall mean that at the time of the examination the Member State is not the subject of a Council decision under Article 104c(6) of this Treaty that an excessive deficit exists".

At the ECOFIN meeting of 1 May 1998, following Commission recommendations, the Council abrogated the Decisions on an excessive deficit for Belgium, Germany, Spain, France, Italy, Austria, Portugal, Sweden and the United Kingdom, thus bringing the Member States which "no longer have an excessive deficit" to fourteen, given that the relevant decisions for Denmark were abrogated in 1996, for Finland and The Netherlands in 1997 and that Ireland and Luxembourg never had excessive deficits since the launch of the excessive deficit procedure in 1994.

As regards Belgium, ECOFIN noted that government debt peaked in 1993 at 135.2% of GDP but has declined every year and stood at 122.2% in 1997, with a further improvement expected in 1998 and projected to continue in the following years. Nevertheless the figure remains twice the Maastricht reference value and it is doubtful if it gen-

uinely meets the spirit of the “virtuous curve” criterion set by Article 104(2)(b) (ex Article 104c) mentioned above. Likewise Italian government debt peaked in 1994 at 124.9% of GDP but has since then declined each year to reach 121.6% in 1997. Further reductions are expected with the Italian Government pledging to reduce the debt ratio below 100% by 2003. It should be noted that the Italian performance is not as good as that of Belgium, and moreover the aim of a reduction to 100% by 2003 is still completely out of range of the convergence criteria.<sup>3</sup>

Of the other countries which exceeded the reference value, Germany was just above the 60% GDP reference value in 1997, having actually risen in both 1995 (sharply) and 1996. Thus a “virtuous curve” was not apparent, although debt is expected to decline in 1998. Of the others, the virtuous curve syndrome showing declines was apparent in the 1997 debt ratio figures for Spain (68.8%), Austria (66.1%), Portugal (62%), Sweden (76.6%), with further reductions expected in each case. By contrast government debt in France has been rising (58% in 1997) but has never exceeded the reference value. The United Kingdom government debt ratio has never been above the Treaty reference value; after having increased for several years, it fell to 53.4% in 1997. Overall, however, the number of countries which failed to meet the criterion and the leniency accorded to them is striking.

(ii) *ERM stability*. The Council decision examined in each case the Maastricht criterion relating to the observance of the normal fluctuation margins provided for by the ERM of the European Monetary System (EMS), for at least two years, without devaluing against the currency of any other Member State. Here too it took a flexible approach. It will be recalled that in Article 3 of the Protocol on the Convergence Criteria (referred to above) the criterion on participation in the ERM

3. The 100% goal is moreover dependent upon the implementation of a medium-term financial programme which calls for large-scale reduction in public spending, approved by Parliament literally on the eve of the examination, and is programmatic rather than being binding in the implementation of actual policy measures as the last Italian Government crisis showed when a budget based on the previous medium-term financial programme was rejected by a political party holding the balance of power even though it had voted for the programme.

means that a Member State has respected the normal fluctuation margins provided for by the ERM without severe tensions “for at least the last two years before the examination”. Given that the examination took place in May 1998, it is arguable that a full two-year prior interval should have elapsed before the examination, to comply with the terms of the Protocol.

In the case of Italy, the Council noted that although Italy had rejoined the ERM in November 1996, and thus before two years had elapsed, it had displayed sufficient stability in “the last two years”. The same approach was taken for Finland, which joined the ERM in October 1996 and prior to that had appreciated *vis-à-vis* the ERM currencies. In the case of Greece, it was noted that the currency of Greece did not participate in the ERM in the two years ending in February 1998; during this period the Greek currency had been relatively stable against the ERM currencies, but it had experienced tensions at times. Greece joined the ERM in March 1998. Moreover in the case of Sweden, the decision related that Sweden has never participated in the ERM and in the two years under review, the Swedish krona fluctuated against the ERM currencies, reflecting among others the absence of an exchange rate target.

It can be seen from the insistence of the Council decision on ERM membership that if the United Kingdom decides to opt in to EMU, it would seem, contrary to what it has maintained, to be required to rejoin the ERM for a certain period; however given the treatment afforded to Italy, it may be that this period does not need to be as long as the full two years required by the Treaty. Alternatively, or additionally, given the example of the comment regarding Sweden, perhaps fluctuation against ERM currencies may be defined as the crucial parameter. In the event, however, political realities may obviate strict observance of this requirement either in whole or in part.

It should be noted that the fact that Ireland revalued its currency on 16 March 1998 against the bilateral central rates of the IEP against all other ERM currencies was not held against it; apparently the true interpretation of Article 121(1) third indent (ex Article 109j), which requires “the observance of the normal fluctuation margins provided for by the exchange-rate mechanism . . . for at least two years, without

devaluing against the currency of any other Member States”, is not so much the observance of normal fluctuations, but rather that within the terms of that provision, there is no *devaluation* against the currency of another Member State. Considering that the aim of this particular criterion is to examine convergence through the optic of exchange-rate *stability*, this interpretation is striking.

(iii) *Independence of the national central banks*. It may be remarked that amongst all the Member States examined, Sweden was the only Member State not to have met the condition concerning the independence of national central banks in accordance with Articles 108 and 109 (ex Articles 107 and 108) of the Treaty and the Statute of the ECB. Indeed, it is noteworthy that Sweden was considered at all for this exercise, given its decision not to participate. This would seem to bear out the view that only those Member States, notably Denmark and the United Kingdom, which reserved their rights regarding eventual participation in the third stage are excluded from the examination process. One wonders if this implies that if an unwilling Sweden had been found to comply with the necessary conditions, it could have been required as a matter of Treaty obligation to join the third stage. Apart from non-membership of the ERM, which as has been stated above has been interpreted fairly flexibly, the only condition which Sweden did not satisfy was the independence of its Central Bank. One wonders whether the Commission could have in fact brought an Article 169 and Article 5 action against it on that ground.<sup>4</sup> However in the world of *realpolitik*, this was not to be expected.

3. In a Declaration attached to the ECOFIN recommendations of 1 May, the Ministers, adopting the so-called Waigel plan, insisted that strong, sustained and non-inflationary growth will continue to be based in all Member States on economic convergence. Sound and sustainable public finances are prior conditions for growth and the reduction of unemployment. The Stability Pact<sup>5</sup> provides the means for securing this objective and thus, in accordance with the Pact, the ECOFIN will

4. Strictly speaking, independence of the central bank is required as of entry into the third stage.

5. Resolution of the European Council on the Stability and Growth Pact of 17 June 1997, O.J. 1997, C 236/1. See also Hahn, “The Stability Pact for European

start to implement Regulation 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies<sup>6</sup> as regards the 1998 and 1999 budgets. If economic conditions develop better than expected, Member States will be required to use the opportunity to reinforce budgetary consolidation so as to reach the medium term objective of government financial positions close to balance or surplus, as outlined in the Stability Pact.

As regards Member States with high debt ratios, in addition to maintaining appropriate levels of primary surpluses (Italy and Belgium for example have projected a primary surplus of around 6% yearly), other measures should be put into place to reduce gross debt, i.e. further cuts in public spending or increased taxation. National stability or convergence programmes reflecting these goals must be submitted by the end of 1998 at the latest.

Finally, in a welcome move, the ECOFIN Ministers linked these economic measures with growth, high employment and social cohesion. The preparation of the broad economic policy guidelines will draw on the Employment Action Plans as well as on progress regarding product and capital markets.<sup>7</sup>

4. It should not be forgotten that the events of the weekend of 1–2 May are only part of a package of legislation to prepare for the more technical aspects of the introduction of the single currency.<sup>8</sup> Further

Monetary Union: Compliance with deficit limit as a constant legal duty", 35 *CML Rev.*, 77–100.

6. Council Regulation (EC) 1466/97, O.J. 1997, L 209.

7. See Resolution of the European Council on Growth and unemployment of 16 June 1997, O.J. 1997, C 236/3.

8. These include Regulation 1103/97 on certain provisions relating to the introduction of the euro, O.J. 1997, L 162 and draft Regulation . . . /97 on the introduction of the Euro, O.J. 1997, C 236; the Stability and Growth Pact itself which has been implemented by Regulation 1466/97; and Regulation 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure, O.J. 1997, L 209. There is also the Resolution of the European Council on the establishment of an exchange-rate mechanism in the third stage of economic and monetary union (O.J. 1997, C 236/5); Regulation 3603/93 on the prohibition of direct financing of the public sector referred to in Articles 104 and 104b(1) of the Treaty, O.J. 1993, L 332/1; Regulation 3604/93 on the prohibition of privileged access referred to in Article 104a



legislation needs to be adopted concerning the activities and prerogatives of the ECB and the creation of the Economic and Financial Committee as well as a whole raft of legislation concerning the actual introduction of the Euro. At Brussels, the bilateral exchange rates which will be used to determine the conversion rates of the Euro were also apparently adopted although the final parity rates with the Euro will not be able to be announced until the beginning of the third stage.

5. From 1 January 1999, this historic enterprise will start to function, and will be felt most keenly by citizens by 1 July 2002, when the euro replaces national currencies. It will have its consequences for social, fiscal and perhaps other policies. Some of the really big questions remain unanswered, such as the wisdom or feasibility of the one-size-fits-all philosophy of the single monetary policy which will be conducted by the ECB, and the lack of mechanisms for the transfer of central funds to States or regions experiencing severe economic difficulties, such as recession or mass unemployment. The political accountability of the ECB is also a question although it has its own nascent informal political counterpart to the ECB in the Euro-X Council.<sup>9</sup>

However, already a new sort of Europe is taking shape, the European Monetary Union. Ministers participating at the Brussels meetings publicly voiced the need to accompany EMU with a really effective CFSP and a security policy, revising the as yet unratified Amsterdam Treaty. The train has started to move. In retrospect, if the Euro proves a success, the dispute over the ECB's first President may prove to have been only an infant disease; if not, it may well presage incompatibilities

of the Treaty, O.J. 1993, L 332/4; and Regulation 3605/93 on the application of the protocol on the excessive deficit procedure O.J. L 332/7.

9. "The Ministers of the States participating in the euro area may meet informally among themselves to discuss issues connected with their shared specific responsibilities for the single currency. The Commission and the European Central bank when appropriate, will be invited to take part in the meetings. Whenever matters of common interest are concerned they will be discussed by all Member states. Decisions will in all cases be taken by the ECOFIN Council in accordance with the procedures laid down in the Treaty": Presidency Conclusions, Luxembourg summit, 12 and 13 Dec. 1997, point 44 and Annex 1 thereto, point 6.

between a strict monetary policy and price stability on the one hand, and on the other the demands of Member States who, faced with lack of growth, rising unemployment, exclusion and social tension, argue for adequate focus of monetary policy to “support the general economic policies in the Community with a view to contributing to the achievement of the objectives of the Community”, as is set out in Article 105 EC.