

EUROPEAN MONETARY UNION AND ITS EURO EFFECTS

(WITH A FOCUS ON THE UK)

THESIS

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Forward

The European Union came into existence on November 1, 1993 with the Maastricht Treaty, also known as the Treaty of the European Union (TEU). The ultimate goal of the European Union is “an ever closer union among the peoples of Europe, in which decisions are taken as closely as possible to the citizen.”¹ Its objective is to promote economic and social process, which is balanced and sustainable, assert the European identity on the international scene and introduce a European citizenship for the nationals of the Member States. During its brief history, the European Union (EU) has grown greatly, presently covering fifteen Member States in its economic and political areas. The Union’s main objectives for the coming years are:

- Implementation of the Treaty of Amsterdam (which focuses on strengthening the institutions of the European Union and rights for citizens.)
- Agenda 2000 (which concentrates on the enlargement of the EU by considering applicant countries from central and eastern Europe.)
- The creation of the euro.²

This thesis examines the history of economic integration in Europe, with a special emphasis on the European Monetary Union (EMU). Furthermore, I will specifically evaluate the European Union efforts to launch the euro. To show how these efforts have been received in a particular country, I will discuss the United Kingdom’s

¹ European Union homepage: <http://europa.eu.int/abc-en.html>
last update: August 1998.

² European Union homepage: <http://europa.eu.int/abc-en.html>

(UK) standpoint. This case study will examine the issue of British participation in the EMU, and the debate over the benefits or disadvantages to the British economy.

In the conclusion, I will offer some thoughts of how EMU may succeed in the future and what factors can contribute to a successful monetary union. EMU's future will depend on the European Community, as it will attempt to survive an integrated monetary union, surrounded by different cultural values and political institutions. These differences of values and institutions must be counterbalanced by a dynamic economy. Furthermore, I will discuss how governments and businesses can prepare for the single currency, as the euro is introduced on January 1, 1999 in Continental Europe.

Calendar

There have been proposals for greater economic cooperation within Europe, including a single currency, in the last two decades:

- In **1979**, the **European Monetary System** was set up, and the **ERM** was established.
- In **1992**, **The Maastricht Treaty** provided an economic, political and legal framework for the single currency, incorporating the following three stages:
 - **1992**: The first stage. Focus on economic and monetary cooperation and the development of the single market, which was the removal of all non-tariff barriers to the free movement of goods, services, people and capital.³
 - **January 1994**: The second stage. This involved closer cooperation and the setting up of the European Monetary Institute (**EMI**) and early preparation for the future European Central Bank (ECB).
 - **January 1, 1999**: The third stage of EMU is scheduled to begin. It will involve the introduction of the single currency, the euro.
- **May 2, 1998**: Those countries that have met the criteria were confirmed in whom could participate in the single currency. Also, those countries joining the third stage confirmed cross exchange rate details.
- **June 1998**. The European Monetary Institute became the European Central Bank.
“The ECB is independent of national governments, and is obliged by its founding statute to ‘maintain price stability’ as its primary objective.” Effective from January

³ European Commission Representation in the UK. (February 1997). European Monetary Union and the euro.

Internet website address: <http://www.cec.org.uk/pubs/brief/brief04.htm>

1, 1999, the ECB will be the top leader in a new “European System of Central Banks.”⁴

- **January 1999.** Conversion rates between the currencies of qualifying countries and the euro will be legally and irrevocably fixed. The euro will become legal currency in those countries. In addition, the ECB will become responsible for interest rates as financial markets will operate in euros and the private sector will use the euro under a no prohibition, no obligation principle.
- **Until 2002 (the transitional period).** National currencies will continue to exist in parallel to the euro, but will change in status. They will be temporary 'units' of the euro. Businesses will be able to choose to use the euro or national currency denominations for transactions. Since no euro banknotes or coins will be available, national banknotes and coins will be used for all cash transactions.
- **January - July 2002.** Euro banknotes and coins will be introduced in participating countries at the start of this phase. They will circulate alongside national banknotes and coins.
- **July 2002 (at the latest).** National banknotes and coins will be withdrawn. The euro will have replaced the currencies of the participating countries for all purposes.⁵

⁴ *The Economist*. (October 17th- 23rd, 1998). Euro Brief: Eleven into one may go. V:349, No. 8090, pp. 81-82

⁵ Euro: Get ready for the euro on 1 January 1999. *Timetable for countries introducing the euro on 1 January 1999*.

Internet website address: <http://www.euro.gov.uk/will/time.html>

Part 1: EU Background & Institutions

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CHAPTER 1: Historical Integration

The peaceful economic integration of the fifteen member countries¹ came about from a slow evolutionary integration process during the post-1945 era. The integration was encouraged by political, economic, and security issues within Europe that had dealt with the historical encounters of two World Wars within a thirty year time frame, the Depression of the 1930s, and the danger and threat of fascism and communism. On account of these issues, many Western European governments understood that it was necessary to surrender some of their sovereignty to restore peace, democracy and stability. At the time, European citizens wanted to regenerate their national economies through economic reconstruction and growth. The answer appeared to lie within certain countries that wanted integration to take place in order to ensure the future stability of Europe.²

European Coal and Steel Community

European integration began with the European Coal and Steel Community (ECSC). In May 1950, Robert Schuman, the French Foreign Minister, suggested the concept of establishing the ECSC, which was also warmly welcomed by the Chancellor of the German Federal Republic, Konrad Adenauer. The immediate political aim of the ECSC was to eliminate the danger of increased hostility between France and Germany by joining the two basic elements in their economies, the production of coal and the

¹ The 15 Member States are: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, The Netherlands, Portugal, Spain, Sweden and the United Kingdom.

² Schmitt, Hans A. (1962). *The Path to European Union: From the Marshall Plan to the Common Market*. Baton Rouge: Louisiana State University Press, p. 33

manufacture of steel, more firmly together.³ Both countries invited others to join them. Countries that accepted the invitation were Belgium, Italy, Luxembourg and the Netherlands.

The ECSC was as successful in both its immediate economic aims, as it was in its long-term political objectives. The ECSC gave the French passage to the abundant coal deposits of the Ruhr, and terminated the dual pricing system between the French and the Germans. Additionally, the six participating countries within the ECSC removed all customs barriers to the sale of coal and steel. The effects of the removal of the customs barriers to each member state was that interstate trading in steel had increased by 151 per cent, coal by 21 per cent and that of iron ore by 25 per cent by 1958.⁴

The ECSC supplied the foundation for the European Economic Community (EEC) of 1958, where the six member states decided to transfer the control and care of significant sections of what had previously been seen as their national economies to supranational oversight and regulation.⁵ This community would be referred to as the Common Market. However, despite the transfers of power, the six member states wanted to maintain their own distinctiveness. Still, they wanted to work amicably with fellow member states with whom they shared many interests than merely financial or material ones. Objectives of the EEC were to promote and expand the accomplishments of the ECSC, and to extend the benefits of free trade to wider integration. In addition, the EEC

³ Thody, Philip. (1997). *A Historical Introduction to the European Union*. London: Routledge, p.1.

⁴ Dedman, Martin J. (1996). *The Origins and Development of the European Union, 1951-1995*. London: Routledge, pp. 60-9.

wanted to establish a Common External Tariff, thus widening the customs union first established in the ECSC.⁶

The Treaty of Rome

The Treaty of Rome, which came into effect on January 1, 1958, established the EEC. The treaty was ratified by the parliaments of Belgium, France, the Federal Republic of Germany, Italy, Luxembourg, and The Netherlands, commonly known as “the Six.”⁷ The Treaty set up an executive branch, a judiciary branch and a legislative branch, where governments retained legislative authority in the Council of Ministers.⁸

The treaty did not arrange for a monetary union, but did require economic policy coordination. Known as the four fundamental freedoms of the European Community, the treaty guaranteed the promise of the free movement of goods, services, capital, and people throughout the Community in the determination on eliminating quotas and customs duties.⁹ A common market and a common external tariff (Customs Union) that would be established for all goods would accomplish this. In addition, common policies would be devised for agriculture, transport, labor mobility, and important sectors of the economy. The main goal of implementing all of these measures was to improve the lives of the peoples of the member countries.¹⁰

⁵ Crawford, Malcolm. (1996). *One Money for Europe? The Economics and Politics of EMU*. NY: St. Martin's Press, pp. 3-5.

⁶ Crawford, Malcolm. (1996). *One Money for Europe? The Economics and Politics of EMU*. NY: St Martin's Press, pp. 3-6.

⁷ Pryce, Roy. (1987). *The Dynamics of the European Union*. NY: Croom Helm, p. 92.

⁸ Brooks, John. (1963). *The European Common Market*. NY: Smith, Keynes, and Marshall Publishers. p. 16.

⁹ Crawford, Malcolm. (1996). *One Money for Europe? The Economics and Politics of EMU*. NY: St. Martin's Press, p.13.

¹⁰ Paxton, John. (1977). *A Dictionary of the European Economic Community*. NY: Facts on File Inc., p. 220.

The Treaty of Rome's objective of building a common market was partly achieved on July 1, 1968 when customs duties and limits on trade were abolished among the six member states.¹¹ As this goal of abolishing duties was achieved, the EC planned to aspire to tackle even more challenging sectors including establishment of a common currency.¹²

¹¹ Despite the progress made in abolishing customs duties on July 1, 1968, it was not until January 1, 1993 that all frontier controls on goods circulating in the European Union finally disappeared.

¹² Crawford, Malcolm. (1996). *One Money for Europe? The Economics and Politics of EMU*. NY: St. Martin's Press, pp.14-15.

CHAPTER 2: Organizations and Powers

Generally speaking, the European Union lacks many conventional characteristics of the nation states, for instance, a unified system of government. It does not have an army to defend its citizens against external aggression, or police enforcement to protect them from domestic disturbances and uproar. It has not yet developed a common foreign policy, and has no common language. It also does not collect income tax from individuals or corporate tax from institutions. However, the EU does possess institutions, and most of the legal powers are connected in some way with economics.

It is important to highlight the major institutions since they play important roles in the decision-making processes of the European Union. The Treaty of Rome established the different organs to monitor the economic plan and layout of a Common Market. The following is a brief summary of the major institutions, and what roles they play in the making of the European Union.

The Commission is a body that exists independently of the individual states, and in conjunction with all the other bodies of the European Union, has the right to take initiatives and propose legislation to the member governments on behalf of the Union itself. The Commission also ensures that the decisions of the institutions and the treaties are implemented, manages the budget and represents the EU in international trade negotiations. Commissioners are appointed for a 5-year, renewable term, and are proposed for membership by the country of which they are citizens. The main

administrative units in the European Commission are the Directorates-General. The European Commission's headquarters are in the Berlaymont building in Brussels.¹³

The Council of the European Union or Council of Ministers is the main decision-making, i.e. "legislative" body of the Union and of the European Parliament. The Council is an inter-governmental assembly, where a minister from each member government represents each of the fifteen states in the European Union.¹⁴ The Council approves all major decisions about movement towards integration by a modified and weighted vote.

The European Parliament supervises the executive and approves the President of the Commission. It reviews and has the power to reject legislative proposals approved by the Council. In addition, it has formal power to elicit information on policy from the Commission by written or oral question.¹⁵ It has 626 full-time members, who are directly elected for a period of five years, which corresponds with the period of office of the European Commission.

The Court of Justice of the European Communities resides in Luxembourg, and is the only body free to interpret the treaties on the basis and principles of which the European Union is instituted. It also interprets the legislation introduced by the Commission and approved by the European Parliament and the Council of Ministers. The Court has fifteen judges, appointed for a renewable six-year term that is approved by the fifteen-member states. It is summoned to provide judgement in cases where it is

¹³ Thody, Philip. (1997). *A Historical Introduction to the European Union*. London: Routledge, pp. 20-35.

necessary to formulate a model in the rendition of Community law. The interpretation is based upon the primary intention and meaning of the original law. The Court of Justice resides in Luxembourg.

The European Council provides a sort of a backdrop for the problem-solving methods of the European Community, and it draws the heads of government of the member states together. It holds meetings when serious issues are to be discussed that effect both the internal and external community. Examples of such issues are the creation of the European Monetary System and discussions on German reunification in the 1980s.

Other groups that complement or behave in an advisory fashion in the European Union are the Economic and Social Committee (which delineates various interest groups), and the Committee of the Regions (which arranges for more deliberation under European Union legislation, concerning itself primarily with educational, social, cultural, and regional issues). Furthermore, the European Investment Bank and the European Monetary Institute (which oversees the preparation for the introduction of the single currency on January 1, 1999) also acts in an informational manner.¹⁶

¹⁴ Thody, Philip. (1997). *A Historical Introduction to the European Union*. London: Routledge, pp. 20-35.

¹⁵ Paxton, John. (1977). *A Dictionary of the European Economic Community*. NY: Facts on File Inc., p. 201.

¹⁶ Thody, Philip. (1997). *A Historical Introduction to the European Union*. London: Routledge, pp. 20-35.

Part 2: EUROPEAN MONETARY SYSTEM AND EUROPEAN MONETARY UNION

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CHAPTER 3: Background of EMS

The European Monetary System (EMS) was established in March 1979 in an effort to strengthen the coordination of monetary and economic policies among the members of the Community, to stabilize exchange rates, and to take a new step on the road to monetary unification in Europe.¹⁷ The decision to establish such a system was instituted by casual discussions in the mid-60s by various economists and policy-makers who wanted to move Continental Europe towards a direction of a more improved and stable economy by a management of European macroeconomic policy.¹⁸

Discussions focused on monetary unification and what a monetary union would entail. A monetary union would be a union where national currencies and exchange rates are permanently fixed, or where they may be replaced by a common currency, where there are no restrictions between monetary and financial movements. Discussions also included whether a monetary union would be in the best interest of the European economy, as a monetary union could act as a cushion against the effects of serious external events.¹⁹

These examinations in turn led to the report of the Barre Plan, in February 1969, to the Council of Ministers. The main point of the plan was to propose a formulation of common economic policies that would maintain economic equilibrium between each

¹⁷ Fratianni, Michele and Hagen, Jurgen von. (1992). *The European Monetary System and The European Monetary System*. Oxford: Westview Press, p. 21.

¹⁸ Archer, Clive, and Butler, Fiona. (1994). *The European Community: Structure and Process*. NY: St. Martin's Press, p. 78.

member country. By January 1970, the Barre Plan was implemented with many of the proposals considered, which included surroundings for repeated discussions of economic policies.²⁰

Various other blueprints for expansion of monetary transactions and policy were expressed during the next few years, including the first and second Warner Reports. These reports suggested a goal of full economic and monetary union by 1980, where regional imbalances would be addressed.²¹ The first report stated that exchange rate changes might be considered until the final stage of transition, at which point they would be eliminated. The second report stressed the necessity for the certain transfer of decision-making powers from national to Community levels in the economic arena, as well as including a system of central banks at the same level. Europe's heads of state approved this report in 1971.²²

In 1972, another effort to create greater monetary stability took place in Europe when France and the Federal Republic of Germany suggested the origin of what quickly became known as the 'snake in the tunnel.' The snake in the tunnel was a figure that represented "the way that all the currencies of the Community would vary together in their relationship with the dollar, rather as a snake might go up and down beneath the

¹⁹ Archer, Clive, and Butler, Fiona. (1994). *The European Community: Structure and Process*. NY: St. Martin's Press, p. 79.

²⁰ Crawford, Malcolm. (1996). *One Money for Europe? The Economics and Politics of EMU*. NY: St. Martin's Press, p. 17.

²¹ Hodges, Michael, and Wallace, William. (1981). *Economic Divergence in the European Community*. London: Royal Institute of International Affairs, p.6.

²² Crawford, Malcolm. (1996). *One Money for Europe? The Economics and Politics of EMU*. NY: St. Martin's Press, p. 17.

ground as it moved along inside a tunnel.”²³ Each currency differed in its relationship to the others, but never went outside the skin of snake as the group of currencies went up and down.

That same year, the limits were somewhat narrowed within which the countries taking part in the snake allowed their currencies to deviate. A currency desiring to stay within the snake was not allowed to vary by more than 2.5 per cent above or below the line.²⁴ If and when a pair of currencies reached the outer limits of their bilateral margins, the central bank in each country was required to intervene to correct the situation.²⁵ The situation was corrected by “weak-currency central banks selling foreign exchange in the exchange to prevent its currency from depreciating further; conversely, strong currency central banks had to sell its own currency for foreign currency.”²⁶

However, the snake soon ran into trouble when speculation against the UK sterling resulted in sterling being floated and British withdrawal from the snake. During its involvement, the Britain lost about 30 percent of their reserves.²⁷ Other participating members, such as France and Italy, also withdrew from the wave of currency speculation. Soon after, the snake collapsed, eventually leading to a situation “whereby collective action over exchange rates was replaced by a confusing mixture of unilateral floating

²³ Thody, Philip. (1997). *A Historical Introduction to the European Union*. London: Routledge, p. 81.

²⁴ Thody, Philip. (1997). *A Historical Introduction to the European Union*. London: Routledge, p. 81.

²⁵ Ludlow, Peter. (1982). *The Making of the European Monetary System*. London: Butterworth Scientific, p. 3.

²⁶ Fratianni, Michele and Hagen, Jorgen von. (1992). *The European Monetary System and The European Monetary System*. Oxford: Westview Press, p. 23.

²⁷ Coffrey, John. (1987). *The European Monetary System: Past, Present, and Future*. Netherlands: Martinus Nijhoff Publishers, p. 19.

exchange rates”²⁸ and a partial cooperation of some Western European states remaining within the snake.

EMS

Another effort to create further monetary stability was initiated by France and the Federal Republic of Germany in 1978, when they proposed the creation of the European Monetary System (EMS). Subsequently, in 1979, the European Monetary System was established by the European Economic Community to stabilize currency values and to secure a zone of monetary stability in Western Europe. The EMS was a first step towards Economic and Monetary Union (EMU). The Exchange Rate Mechanism (ERM) and the European Currency Unit (ECU) acted as its core elements.

The Exchange Rate Mechanism (ERM) of the EMS symbolized the foundation of international monetary arrangements within Europe.²⁹ The ERM was the EMS’s major core component, as it provided a means for stabilizing exchange rates between member states of the EMS. One of the main purposes of the ERM has been to sustain realignments to a minimum and to prevent the devaluation being used as a competing tool of policy within Europe.³⁰

²⁸ Archer, Clive, and Butler, Fiona. (1994). *The European Community: Structure and Process*. NY: St. Martin’s Press, p. 81.

²⁹ The ERM provides for a ‘currency grid’, a set of all bilateral exchange rates between participating countries with a nominated central rate for each and permissible band of fluctuation.

³⁰ Artis, Mike, and Lee, Norman. (1994). *The Economics of the European Union*. Oxford: Oxford University Press, p. 10.

Great Britain ultimately chose not to join the ERM³¹ mainly for political reasons, as a general election was near when the Labour government made its negative decision. The Chancellor defended the decision not to join the ERM by offering an explanation that the system, as designed, was one in which the responsibility for adjusting policies would tend to fall “unequally” on the less prosperous member states. There was also concern, especially in the Treasury, that higher inflation in the UK, combined with a fixed exchange rate, would continuously worsen British industry’s competitiveness. Finally, the UK joined in 1990 but withdrew from the ERM in the fall of 1992 due to reasons of insecurity, poor judgement and a fragile economy.³²

Moreover, the EMS was strictly organized around a group of EC currencies that involve the European Currency Unit (ECU, now called the Euro). The ECU is “the numeraire for the ERM and the unit accounts for all EC transaction. It is a composite currency that contains specific amounts of the currencies of all Member States, including those, which do not participate in the ERM.”³³ It acts as an accounting unit between central banks, and is not a freely traded currency.

The value of the ECU in terms of each currency constantly changes as the weight of each currency changes daily, according to changes in market rates. These changes occur because the value of a fixed number of units of any component currency changes in

³¹ The UK did fulfill other obligations of EMS membership, together with the inclusion of the sterling as a component in the ECU.

³² Dinan, Desmond. (1994). *Ever Closer Union?: An Introduction to the European Community*. Colorado: Lynne Rienner Publishers, p. 181.

³³ Artis, Mike, and Lee, Norman. (1994). *The Economics of the European Union*. Oxford: Oxford University Press, p. 329.

relation to the value of each of the other components. The ECU will be removed from use when the euro is introduced on January 1,1999.

CHAPTER 4: Origins of European Monetary Union (EMU)

It is necessary to examine the nature of a monetary union before the discussion and background of the EMU can take place. A monetary union is a form of a fixed exchange rate system, which involves a single currency and a single monetary policy. This implies the integration of all markets for goods, services and the factors of production (capital, labor and land). The following is a detailed examination of the transition from ERM to European Monetary Union.

The Transition from EMS to EMU

In the early 1970s, discussions were undertaken that focused on heading Europe towards an economic and monetary union. Although Council decisions included references to EMS, no mention was made about an EMU. This was due to the difficulties associated with implementing EMU and that the overall concept lacked credibility. In addition, Europe's problems were intensified by competitive devaluations between currencies that generated political frictions and rivalries amongst the Member States. By the late 1970s, EMU was barely visible both in discussions and reality, and up until the mid-1980s, the EMS itself was in the danger of not surviving.³⁴

However, the 1980s brought a key development for the European economy: the Single Market. This was an agreement within the participating EU countries that all non-tariff barriers to the free movement of goods, services, people and capital would be

eliminated. To the members, the full benefits of the Single Market could only be achieved when “the relatively high transaction costs of converting between currencies were eliminated and the uncertainties created by unstable exchange rates were removed.”³⁵ These goals of relative stability in exchange rates were in fact achieved, as “the exchange rate variability was half what it had been in 1975-79; it halved again between 1986 and 1989.”³⁶

Delors Report

These results proved to be positive for the community, and this new confidence led to the Delors Committee in June 1988. The Delors Committee was a heightened proceeding of intergovernmental conference and negotiation that focused on heading towards a full European monetary union. The Committee considered a report (Delors Report) which would determine the notable characteristics of an economic union that included a “common market, competition policy, common policies for structural change and regional development, and co-ordination for macroeconomic policies.”³⁷

In addition, the report recommended three stages for the transition to a full monetary union.³⁸ In stage one, reforms on structural funds would take place and the

³⁴ Crawford, Malcolm. (1996). *One Money for Europe? The Economics and Politics of EMU*. NY: St Martin's Press, p. 78.

³⁵ The European Commission Representation in the UK. (February 1997). *European Monetary Union and the euro*. Internet website address : <http://www.cec.org.uk/pubs/brief/brief04.htm>

³⁶ The European Commission Representation in the UK. (February 1997). *European Monetary Union and the euro*. Internet website address : <http://www.cec.org.uk/pubs/brief/brief04.htm>

³⁷ Crawford, Malcolm. (1996). *One Money for Europe? The Economics and Politics of EMU*. NY: St. Martin's Press, p. 79.

³⁸ *The Economist*. (October 17th- 23rd, 1998). Euro Brief: Eleven into one may go. V:349, No. 8090, pp. 81-82

fund's amount would be doubled. Recommendations would be made where national policies were determined to be deficient.

In stage two, different coordination policies would be fortified and expanded, the setting of decisive rules would be determined, and the establishment of the European System of Central Banks (ESCB) would be created. The ESCB would have the sole responsibility of intervention in non-EC currencies, and would also be responsible for the management and the pooling of reserves.

In stage three, exchange rates would be fixed and the transition to a single monetary policy and a single currency would be well underway and completed. In June 1989, the Delors Report was accepted as Community policy.³⁹

³⁹ Crawford, Malcolm. (1996). *One Money for Europe? The Economics and Politics of EMU*. NY: St. Martin's Press, p. 80.

Maastricht Decisions

The EMU was granted permission to go forward at an intergovernmental conference (IGC), which was established at the European Council meeting in Rome in October 1990. In the middle of these early discussions, with the Commission's recommendations, most member governments decided that a set of specific criteria for entry into EMU would be necessary for member states that would include inflation, interest rates and fiscal positions.

Finally, at the end of 1991 and the beginning of 1992, agreements were made at Maastricht, where member states of the EC determined the final terms of a monetary union in Europe. Members agreed to an Economic and Monetary Union (EMU) in the Maastricht Treaty, which specified the process of moving to a single currency. The resultant Treaty in European Union (TEU) set out a three stage timetable for the approach to full union as well as a constitution for the Central Bank of the Union, which is described below.

First Phase

The first phase began on July 1, 1990, when the EU attempted to balance the financial policy of the Member States for the purpose of encouraging convergence, and when the EU prepared for the complete liberalization of capital movements between most

of the Member States. The central banks were also obligated to consult the other Member States concerning the principal lines in the monetary policy.⁴⁰

Second Phase

Stage Two of EMU began in 1994 and will continue until December 31, 1998.

The main goal in this phase is to make some overall objectives or guidelines for the Member States and for the financial policy within the Community to follow. This phase essentially consists of:

- A goal of greater coordination of economic and monetary policy;
- A commitment to try to avoid excess public deficits;
- The processes leading to the independence of central banks⁴¹ from the participating member governments;
- The establishment and operation of the European Monetary Institute (EMI). Its duties include preparations for Europe's future common currency, the euro.⁴²

As stated above, during this stage, the European Monetary Institute (EMI) was established to prepare the groundwork for the single currency. The European Monetary Institute's mission is to strengthen the cooperation of the monetary policies between member states, promote the role of the ECU and prepare the establishment of the European Central Bank for the third stage. In addition, the EMI promotes the efficiency

⁴⁰ The European Commission Representation in the UK. (February 1997). *European Monetary Union and the euro*. Internet website address: <http://www.cec.org.uk/pubs/brief/brief04.htm>

⁴¹ Central Bank: where a government bases its central banking and financial market policies.

⁴² *The Economist*. (October 17th- 23rd, 1998). Euro Brief: Eleven into one may go. V:349, No. 8090, pp. 81-82.

of payments across borders and watches over the technical part of producing the Euro money.

The EMI also provides reports on progress contributed by member states regarding the achievements of EMU to the Council of Ministers (ECOFIN). The reports additionally assess the independence of Member States' central banks from the member governments⁴³, the integration of markets, the development of the ECU and current account balances.

Third Phase

The third stage of EMU will begin in 1999 when the monetary union will be a reality. The new European currency will be called the euro⁴⁴ and the new *Eurocash* is to replace the national currencies in the year 2002. The various currencies will be fixed, which incidentally does not necessarily have to take place from the start of the third phase.

Furthermore, the European Central Bank (ECB) was established on June 1, 1998, and will become a supranational budgetary authority as it will take care of monetary and currency policy in the participating member countries⁴⁵, while the other various central banks will be merely reconstituted. In specific terms, the following sequence of steps takes place during this phase:

⁴³ Frazer, William. (1994). *The Central Banks: The International and European Directions*. London: Praeger Publishers, p. 5.

⁴⁴ *The Economist*. (October 17th- 23rd, 1998). Euro Brief: Eleven into one may go. V:349, No. 8090, pp. 81-82.

⁴⁵ Frieden, Jeffry. (Fall 1998). The Euro: Who Wins? Who Loses? *Foreign Policy*. No. 112, p.39.

- **Interim Period** - this is the time between the decision to go ahead and the beginning of Stage 3, when Member States decide which states have achieved the necessary level of economic convergence.
- **Stage 3a** - on January 1, 1999, EMU will effectively begin amongst the participating Member States, when the euro will become a currency in its own right. The rates of conversion between the euro and the participating countries' currencies will be irrevocably fixed.⁴⁶ It is visualized that the single currency and the relevant national currencies would be used in parallel during this stage, but they would be freely exchangeable in unlimited quantities at the locked parities. The transition to this phase will be evaluated based on the economic convergence consisting of four extensive criteria that is discussed in the following section.
- **Stage 3b**- this is the stage when the single currency is used more widely and in the form of notes and coins. This will take place in 2002, and will signify the final changeover to the euro.⁴⁷ This phase is anticipated to take up to six months to implement, and is emphasized to last no longer than necessary in order "to minimize the complications for users that could be caused by national currencies remaining in

⁴⁶ The European Commission Representation in the UK. (February 1997). *European Monetary Union and the euro*. Internet website address: <http://www.cec.org.uk/pubs/brief/brief04.htm>.

⁴⁷ The European Commission Representation in the UK. (February 1997). *European Monetary Union and the euro*. Internet website address: <http://www.cec.org.uk/pubs/brief/brief04.htm>.

circulation alongside the single currency.”⁴⁸ At the end of the implementation, the euro banknotes and coins will possess legal tender status.

Criteria

The treaty states a set of criteria or suitable conditions for membership which individual countries would have to satisfy, known as the Maastricht criteria. The criteria were intended to ensure that the economies of countries that wanted to join EMU had converged sufficiently for them to adopt a single currency. They cover:

- 1.) Government Debt;
- 2.) Government Deficit;
- 3.) Long term interest rates;
- 4.) Inflation; and
- 5.) Exchange Rate Stability.

While these criteria are undeniably important for the sustainability of EMU, a significant degree of economic integration may prove to be even more important over time if EMU is to succeed. Integration is concerned with the links and inter-relations between countries, and with the similarities of national financial, labor and product markets between them. More of the integration process is described in the following chapter.

⁴⁸ The European Commission Representation in the UK. (February 1997). *European Monetary Union and the euro*.

UK and Denmark

At the time the Maastricht treaty was being settled, two member countries had reservations about the move to a single currency: the UK and Denmark. In 1992, Denmark was skeptical about the integration issue as Danish voters narrowly rejected the treaty in a referendum. Consequently, the speculation and insecurity led to an attack on the ERM that led to the departure of the recently joined British sterling in September 1992.⁴⁹

For Britain, the attacks evolved from the former Prime Minister Margaret Thatcher's reservations regarding European integration and were continued by her successor John Major. However, Major's doubts were not as severe as Thatcher's were, as he had not ruled out the possibility of integration for Britain at some point. Hence, at Maastricht he negotiated the for UK to be positioned out of the euro from the beginning of its launch ('opt-out' clause) but "to 'opt in' later if it wanted and was qualified to do so."⁵⁰ Incidentally, Denmark also chose to have the "opt-in" and "opt-out" clause.

What the "opt-out" clause basically means is that automatic membership to EMU, when fulfilling the convergence criteria, does not apply. In Denmark's case, which is incidentally likely to fulfill the convergence criteria, joining EMU would necessitate a referendum. Likewise, the British government has declared that it may also hold a

Internet website address: <http://www.ccc.org.uk/pubs/brief/brief04.htm>

⁴⁹ Peet John. (April 11, 1998). A Survey of EMU: History of an Idea. *The Economist*. V:347, No. 8063, p. 84.

⁵⁰ *The Economist*. (October 17th- 23rd, 1998). Euro Brief: Eleven into one may go. V:349, No. 8090, pp. 81-82.

referendum of joining EMU sometime in the near future.⁵¹ More of the UK's standpoint is discussed in Part 4 of this thesis.

⁵¹ Peet John. (April 11, 1998). A Survey of EMU: History of an Idea. *The Economist*. V:347, No. 8063, p. 84.

CHAPTER 5: The Implications of EMU

Many issues need to be addressed as a design for one of the world's largest trading blocs approaches. Issues include whether or not economic convergence will bring prosperity, and if it does, what are the terms and conditions in order to achieve it? As a result of these arguable issues, the EMU faces a tough task of decreasing anxiety among European citizens as the heads of the members of the EU, politicians and diplomats move towards formal arrangements for a single currency. The best way to decrease these anxieties and to better educate the citizens is to discuss and explain what EMU really entails and what its effects are to the economic community in Europe. In addition, in examining the pros and cons of EMU, it may be fruitful in understanding what the future may hold for the global economy. A further examination of the single currency is left for chapter 7.

European Monetary Union entails a closer relationship and cooperation between member states on economic issues that are declared in the Maastricht Treaty. It is important to note that the creation of monetary union in Europe does not necessarily involve the creation of a political union. Political union may be inviting to some, but is by no means an obligation in EMU. In addition, the call for political union as a necessary prerequisite for monetary union could delay the creation of the latter. However, those who believe that political union is necessary in EMU assume that a successful single monetary policy has to be backed by common economic, fiscal and employment policies

based on a higher level of political integration. There is a further analysis of a possible political and economic union in the future in the conclusion.

The EMU Members

Eleven Member States have so far published a national changeover plan (Belgium, Ireland, Italy, Luxembourg, the Netherlands, Austria, Finland, France, Portugal, and Spain), or in the case of one (Germany), comprehensive draft transition law. Greece and Sweden have still to meet all the criteria and as mentioned in the previous chapter, UK and Denmark have not yet committed to a joining date.⁵²

The eleven countries that lock their currencies irrevocably together on January 1, 1999 will create radical changes in the institutional framework of the EU. The resulting economic and monetary union will account for 80 percent of the total GDP, 80 percent of the total merchandise trade and 86 percent of the money supply of the European Union.⁵³

The greatest difference between these Member States is the division between the northern EU countries, which are industrialized developed economies and the southern European, or Mediterranean countries that are less developed and have relatively larger agricultural sectors in comparison to the northern EU countries. However, it appears that the gap between this difference has decreased over the last few years, and with increased economic integration, such as the competition in a true internal market and the formation

⁵² The European Commission Representation in the UK. (February 1997). European Monetary Union and the euro. Internet website address: <http://www.cec.org.uk/pubs/brief/brief04.htm>

⁵³ Arrowsmith, John. (February 1998). The Consequences if the UK stayed out of a successful EMU. National Institute of Economic and Social Research. *Times Supplement Ltd.*

of a monetary union, existing structural differences may be eliminated in the foreseeable future.

Economic Integration

As stated above, greater economic integration between member states may decrease differences among them, and hence facilitate and simplify the move to a monetary union. Economic integration may include a high degree of cross-border transaction among the Member States that includes trade, mobility of labor and capital. These types of transactions would require common tax and transfer systems.

However, if a monetary union between economies is not well integrated, it could be subject to severe pressures in the face of different economic shocks. In addition, it could also be subject to differences of opinion in the need to revise contracts specified in national currencies, and the implications of giving legal status to the single currency.

The Maastricht Treaty does allow for various levels of integration for countries wishing to participate in EMU. For example, countries that do not meet the selected economic criteria from the outset will be allowed to participate in the processes developed in order to expedite their future membership into the Union, such as the Governors of their central banks becoming members of the ECB Council.

These Member States will also treat their economic and monetary policy as a matter of common interest as if they were already a part of the Union. However, the

decision making as far as the actual management of the single currency goes will be left to the more active members.⁵⁴

⁵⁴ *Green Paper on the Practical Arrangements for the Introduction of the Single Currency.*
Internet website address: <http://europa.eu.int/euro/en/greenpap/livre21.asp?nav=>
Last update: 28/04/97.

CHAPTER 6: The Pros and Cons of EMU

The advantages and disadvantages of joining the European Monetary Union will vary from country to country, and are difficult to predict. This is because within the EU, each member state has its own financial system, and therefore the introduction of the Euro will have a different impact on each country's economy.⁵⁵

Gains

Supporters of the EMU believe that EMU will be favorable by pointing out that it is going to be much more than the introduction of a new currency unit. It will lead to closer coordination of national economic policies and, if successful, will help the creation of a truly single European market. In addition, EMU will have a profound impact on the European economy, and for non-European companies that will operate in the EU.

A potential gain of being a member of EMU is the elimination of exchange rates, which would increase cross-border trade and investment. This will help the EU expand eastward into the new century and strengthen the commitment of the former communist states of democracy to forming a European powerhouse.⁵⁶ Another advantage is that the single currency, the euro, will fulfill the full benefits of the single European market by improving Europe's position in the global financial market as it becomes a major reserve currency player comparable to the US dollar and the Yen.

⁵⁵BBC Online Network. *EMU: the advantages*.

Internet website address: http://news.bbc.co.uk/hi/english/special_report/single_currency/newsid_66000/66473.stm.

⁵⁶Doughtery, James E. (March 1997). The Politics of European Monetary Union. *Current History*. V: 96, No. 608, p. 127.

In addition, EMU will positively influence the marketplace to refresh their European business outlook, as it will affect marketing, organization, accounting procedures, products, packaging, business processes and employee programs. Leading companies are anticipating this changing marketplace and their actions will cause additional challenges for both their domestic and foreign competitors.

Costs

One of the greatest potential costs of joining EMU is the loss of monetary independence. In the past, the ability to vary exchange rates and to pursue an independent monetary policy has been helpful in encountering a country-specific economic shock. However, it is important to note that the effect of giving up monetary independence is really difficult to quantify, since it implies that the effects will have different impacts on different countries. The effects depend upon changes in monetary policy. Even in the most favorable scenario, where all members of the union were subject to the same external shocks and the same monetary and fiscal policies, differences in economic structure and integration could lead to somewhat different reactions to common shocks and policy changes.

Another disadvantage in EMU is that smaller member countries may have a smaller voice within the determining political processes of the institution. As the EU expands from 15 current members to include at least 6 more countries of Eastern Europe, the role that smaller countries will be allowed to play will become more and more

limited. Current EU voting rules will give way to weighted voting arrangements in which the larger countries have a predominant share of the votes. This change will frustrate countries that recognize that they have sacrificed the ability to control their own domestic policies and their own foreign relations without having received in exchange an effective say in Europe's policies.⁵⁷

One last major cost for the EU in general, and EMU in particular, is that there is little opportunity for a member to withdraw legitimately. If some members want to withdraw for various reasons, such as having malignant economies or for new political stances, it will be difficult to leave, as the majority will be opposed out of general economic self-interest and concern for the whole union.⁵⁸

If withdrawals do occur, it will only occur in extreme circumstances. As stated above, the majority has a massive economic commitment behind the union. A break-up would require legislation, either at the EU or national level (or both), to deal with its effects. A country that wishes to leave EMU would need to reestablish its own currency and to determine the conversion rate by which obligations are converted from the euro to the new, national currency. Most importantly it would be necessary to establish rules for determining which obligations should be converted to that country's new currency and which should remain denominated in euro.⁵⁹

⁵⁷ Feldstein, Martin. (Nov/Dec 1997). EMU and International Conflict. *Foreign Affairs*. V: 76, No. 6, p. 69.

⁵⁸ Feldstein, Martin. (Nov/Dec 1997). EMU and International Conflict. *Foreign Affairs*. V: 76, No. 6, p. 72.

⁵⁹ Arrowsmith, John. (February 1998). The Consequences if the UK stayed out of a successful EMU. *National Institute of Economic and Social Research. Times Supplement Ltd.*

Consequences of Failure of EMU

If EMU fails in the future, monetary and economic integration would be put at a risk, as there would be no incentive for further coordination of economic and fiscal policies. Effects include the likelihood of the increase of exchange rate fluctuations, and this increase would have negative effects on employment and growth, since it would increase uncertainty and slow down productive investment. In addition, the prospect of achieving economies of scale, which was one of the inspirations for the Single Market, would disappear, since companies would be headed towards the spreading of their production capacities over several currency areas.

Furthermore, a failure of EMU could lead to growing instability in European political relations and cooperation. This would endanger future progress in other policy areas, such as the common foreign and security policy, environmental or social policy, and consequently making enlargement of the European Community less likely.

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CHAPTER 7: Advantages of the Euro

The last decade in Europe has been hampered by the problems caused by recession, the rise of unemployment, and the excessive or unwarranted fluctuations of foreign exchange and capital markets. However, the European economy has been on a process of recovery over the last few years, as government control over inflation, care over the utilization of public finances and the reduction of interest rates to all-time lows have all contributed to the course of recovery. Because of these measures, we are seeing more stability in monetary conditions in Europe despite the problems being encountered in Asia.

During this period of positive economic change, the introduction of the euro on January 1, 1999 will help to consolidate the progress made to date, as it will provide a strong and stable currency in the world financial markets.⁶⁰ In addition, the euro will bolster the European economy and the single market, improve business competitiveness, encourage investment, benefit consumers and savers, and make working and traveling in Europe easier for its citizens.⁶¹

The euro will have many advantages. Companies will have a reliable basis on which to plan and cross-border trading will not involve the need (and cost) of changing currencies. (Consumers will not have to ration their currency to last for the length of their

⁶⁰ *EURO 1999, Convergence Report 1998*, p.1.

Internet website address: http://europa.eu.int/comm/off/rep/conver/intro_en.html.

⁶¹ *Green Paper on the Practical Arrangements for the Introduction of the Single Currency*.

Internet website address: <http://europa.eu.int/euro/en/greenpap/livre10.asp?nav=>

visit. They'll be free to spend on impulse!) Without a single currency, exchange rate variability may limit the responsiveness of cross-border investment. In addition, the European currency can become a more important world reserve currency than it is presently and competition intensified by greater transparency in prices will improve the efficiency of the European economies. This will make it possible to safeguard present jobs and create new ones.

The following is a more detailed look at the advantages of the implementation of the euro for the European citizens:

- **An essential supplement to the single market.**

One of the fundamental issues for a single European market to work smoothly is that exchange rate adjustments must not be allowed to disrupt trade or investment through their unanticipated impacts on profitability. This will also affect the purchasing power of consumers and thus the relative wealth of its citizens. Only a single currency covering the largest possible number of Member States can shelter firms and individuals from these disruptions.⁶²

- **A stimulus to growth and employment.**

The single currency will promote investment and employment in two ways:

Last update: 28/04/97.

⁶² *Green Paper on the Practical Arrangements for the Introduction of the Single Currency.*

Internet website address: <http://europa.eu.int/euro/en/greenpap/livre10.asp?nav=>

Last update: 28/04/97.

1. The control of the public deficit will ensure price stability based on a solid economic framework. Therefore, free trade will be encouraged, resources will be better allocated, and this in turn will enhance growth, create more employment, and improve living standards.⁶³
2. Ensuring price and monetary stability throughout Europe is one of the primary objectives of the European Central Bank. The strong constitution of the ECB and its independent status will encourage market confidence. This should translate to lower interest rates especially within the longer-term rates.

- **A factor in lowering costs.**

Transaction costs (the costs of foreign-exchange transactions or the costs of exchange-rate cover) will disappear altogether within the monetary union. These transaction costs are far from negligible: they are estimated to be 0.3-0.4 percent of the Union's gross domestic product, i.e. ECU 20-25 billion. In addition, lower interest rates will provide a further boost to public confidence and consequently provide more enticement for investment, and in turn will involve cheaper borrowing for consumers and cheaper mortgages for homeowners.⁶⁴

⁶³ The European Commission Representation in the UK. (February 1997). *European Monetary Union and the euro*. Internet website address: <http://www.cec.org.uk/pubs/brief/brief04.htm>

⁶⁴ The European Commission Representation in the UK. (February 1997). *European Monetary Union and the euro*. Internet website address: <http://www.cec.org.uk/pubs/brief/brief04.htm>

- **A contribution to international stability.**

The EMU will become a world leading trading power. Europeans will be equipped with an internationally recognized currency and will be able to strive for greater stability in the international monetary system.⁶⁵ With the creation of the Euro will come a currency that will be chosen by many to be one of the main exchange and reserve currencies in the world. It will be placed on equilibrium with the US Dollar or the Japanese Yen.⁶⁶

- **Enhanced joint monetary sovereignty.**

Central banks who are participating in the EMU will collectively manage monetary policy- a new kind of 'joint monetary sovereignty' which aims to divide up roles and responsibilities over one of the strongest currencies in the world so that decisions can be more effectively made.⁶⁷

Keys to Success

In order for the EMU and the euro to be successful, reasonable and responsible behavior has to be taken on the part of economic agents and national authorities that goes beyond mere conformity to the rule of procedure. All Member States have to be aware that each other's actions will affect the European economy as a whole. Each Member State much also learn from past mistakes by taking the opportunities presented by the

⁶⁵ *Green Paper on the Practical Arrangements for the Introduction of the Single Currency.*

Internet website address: <http://europa.eu.int/euro/en/greenpap/livre11.asp?nav=>

Last update: 28/04/97.

⁶⁶ The European Commission Representation in the UK. (February 1997). *European Monetary Union and the euro.*

Internet website address: <http://www.cec.org.uk/pubs/brief/brief04.htm>

⁶⁷ *Green Paper on the Practical Arrangements for the Introduction of the Single Currency.*

Euro to strengthen their improved economic environments. This can be done by consolidating public finance and implementing budgetary policies such that spare capacity can be restored in order to be utilized for further economic change.⁶⁸

Another key to the euro's success is economic growth. The deregulation gripping many Europeans industries is a result of companies preparing to deal with increased competition in the global market place. Foundations are being laid for economic expansion. In the telecom and airline industries, which are already somewhat deregulated, new players are coming into the arena. However, increased price competition will probably be the most visible effect of the introduction of the euro. Price comparability between Member States will become instantly transparent as the same products are traded between markets.⁶⁹

Internet website address: <http://europa.eu.int/euro/en/greenpap/livre11.asp?nav=>

Last update: 28/04/97.

⁶⁸ *EURO 1999, Convergence Report 1998*, p.4.

Internet website address: http://europa.eu.int/comm/off/rep/conver/intro_en.html.

⁶⁹ Edmondson, Gail, Paterson, Thane & Warner Joan. (April 27, 1998). The Euro. *Business Week*. pp. 93.

CHAPTER 8: Disadvantages of the Euro

Many who oppose the single currency, see it as a disastrous endeavor. To them, it is a step further along the road to a federation of Europe, full with unlimited bureaucracy. They also believe and argue that EMU will prove unworkable and divide Europe dangerously into "ins" and "outs". In addition, some argue that the single currency will increase Europe's already high unemployment, and fear that it will not be backed enough with popular support.⁷⁰

Disadvantages of implementing monetary union in Europe are plenty. Member States will give up their right to issue their own money, which is a fundamental element of sovereignty. They will also surrender the ability to run budget deficits to counter mass unemployment. This implies that "Government spending, bond and stock markets and tax policy will all be locked into a European future."⁷¹

"On Jan. 1, 1999, corporate books, bank transfers, credit-card payments, and even home mortgagees will begin to be configured in euros and the European Central Bank will also begin setting interest rates."⁷² The following is a summary of the process of the Euro:

⁷⁰ *The Economist*. (October 17th- 23rd, 1998). Euro Brief: Eleven into one may go. V:349, No. 8090, pp. 81-82.

⁷¹ Edmondson, Gail, Paterson, Thane & Warner Joan. (April 27, 1998). The Euro. *Business Week*. pp. 91-92.

⁷² Edmondson, Gail, Paterson, Thane & Warner Joan. (April 27, 1998). The Euro. *Business Week*. p. 92

Start of EMU

Start of the phase- 1-Jan-1999

At the start of this phase, the list of Member State participants has already been determined. In addition, the production of notes and coins will begin as the European Central Bank (ECB) takes over monetary policy. National currencies will still be used, but stocks and government bonds will be denominated in euros. Finally, bank accounts, credit cards, and prices will be measured in euros.

Throughout the phase:

From the start of the EMU phase until the euro is fully introduced, banks and financial institutions will continue with the changeover to the euro. Additionally, “private and public operators other than banks will proceed with the changeover, circumstances permitting.”⁷³

Single currency fully introduced

Start of the phase- 1-Jan-2002

From January 1, 2002, ECU notes and coins will be introduced. The euro will physically begin to replace national currencies, and retail payments will only be allowed in euros.

1-Jul-2002

By mid 2002, national currencies will cease to exist and be replaced by the euro.

⁷³ Edmondson, Gail, Paterson, Thane & Warner Joan. (April 27, 1998). The Euro. *Business Week*. p. 93 (table).

“For a three-year waiting period, the euro will exist as a unit of currency account; only in 2002 will the euro take physical form as actual cash notes and coins.”⁷⁴ During the three year period, new coins will be minted (1,2,5, 10, and 50 cents, as well as 1 and 2 euros) and seven notes will be printed. On one side of the coin, a European design will be embalmed and the other side will have a national design. On the notes, generic Union designs, such as gateways and arches, will be imprinted on one side, and on the other side, a small section will be saved for a national symbol. Each note will be recognized for its own unique size and governing color. Furthermore, “existing national currencies will cease to be legal tender within EMU member states six months after the euro is placed in circulation on January 1, 2002.”⁷⁵

Those opposing the single currency believe that the simple mechanics of making the process of the Euro operate will likely cause great disturbances. They are convinced that the people will blame the system if a recession hits Europe.⁷⁶ “The new regime will be challenged and will rebuff such attacks only if a stock of support for it has been built up.”⁷⁷

In addition, many EU members will not be able to meet the ‘convergence criteria’ by 1999; thus if EMU occurs, it will split Europe into first- and second-class members and may even impose burdens on trade in the single market. Moreover, as transition

⁷⁴ Dougherty, James E. (March 1997). The Politics of European Monetary Union. *Current History*. V:96, No. 608, p. 127.

⁷⁵ Dougherty, James E. (March 1997). The Politics of European Monetary Union. *Current History*. V:96, No. 608, p. 127.

⁷⁶ Edmondson, Gail, Paterson, Thane & Warner Joan. (April 27, 1998). The Euro. *Business Week*. p. 92

⁷⁷ *The Economist*. (October 11, 1997). Leaders: Ready or Not. V: 345, No. 8038, p. 18.

deadlines approach, “speculators cannot be prevented from disturbing currency markets except by imposing illiberal controls on capital movements.”⁷⁸

There may also be the likelihood of fiscal policy spillovers. Since there will be a uniform European interest rate, individual states whose debts increase will cause interest rates to rise in all other countries. Also, “excessive fiscal discipline may take place when other governments exert pressure on a government to reduce borrowing, or even pay fines if the budget deficit exceeds a reference value, which may have the perverse effect of increasing an existing economic imbalance or deepening a recession.”⁷⁹

⁷⁸ Dougherty, James E. (March 1997). The Politics of European Monetary Union. *Current History*. V: 96, No. 608, p. 127.

⁷⁹ Antweiler, Werner. (July 24, 1998). The Euro: Europe’s New Currency. *Pacific Exchange Rate Services*.
Internet website address: <http://pacific.commerce.ubc.ca/xr/euro/>.

CHAPTER 9: Risks and Effects of the Euro

One of the risks of implementing a common currency is that jobs are most likely to be disrupted. By one estimate, “one in five workers will be affected by mergers and downsizing, and some 5 percent of employees could lose their jobs. It is predicted that as many as a half of the 166,000 bank branches may have to close. Many thousands of workers in these banks could be early casualties of the Euro.”⁸⁰

Companies are also at risk if they do nothing or delay preparation until the last minute, as there will be no time to think the process through, to find proper advice and technical support. These delays would affect all industries, especially retailers and manufacturers who may need and take the longest to complete the changes. Moreover, companies would be put at a substantial competitive disadvantage as they struggle to merely comply.

Effects of the Euro

The introduction of the euro will have profound implications for the financial systems of participating countries. These implications include the financing of government debt, the treatment of contracts specified in national currencies, and relations between national central banks and the ECB. The European Monetary Institute has the responsibility to focus on such issues, and the manner in which it will handle the issues could significantly affect the character of the financial system in EMU.

⁸⁰ Edmondson, Gail, Paterson, Thane & Warner Joan. (April 27, 1998). The Euro. *Business Week*. p. 93.

Moreover, in the absence of clear guidelines there is the potential for conflict between ECOFIN and the ECB. Conflicts can arise when issues relating to exchange rate policies are concerned, as the ECB will be in charge of intervention in the single currency and ECOFIN will cover the overall exchange rate policy.

Who the Euro will Affect

The Euro will affect the eleven founder members of EMU, which accounts for 19.4 percent of GDP and 18.6 percent of trade on a worldwide basis, and has a population of approximately 300 million. Therefore companies and industries, based in or with operations in Europe, will have to carefully consider the impact of EMU, particularly on the financial sector, including both banking and insurance, the retail industry and government agencies.

External Aspects of the Euro

The introduction of the euro will have important implications not only for the Union and its Member States but also for their partners. However, while it will be a major event for international monetary relations and the international monetary system, there will be no abrupt change; nor is it likely to be destabilizing. Markets and the business community are already absorbing how the single currency will effect them when the euro is introduced in 1999.

The EMU will create an area whose economic potential will be comparable to that of the United States. Given the size of the euro area, it is to be expected that the euro will play an important role as an international currency.⁸¹ Its international role will probably first become evident in the countries where economic and trade links with the European Union are strong, as the introduction will reinforce a shift away from the dollar. In the countries of Central and Eastern Europe, for instance, this shift is already taking place - mainly in favor of the Deutsche Mark. However, it is important to note that this development will be gradual, as markets become convinced of the stability orientation of the Euro.⁸² Likewise, the use of the euro as an official reserve currency by third countries is expected to expand.

Finally, there is no reason to expect that the euro exchange rate will be either too strong or too weak against any other currency. Instead, observers should focus on whether it will be a good policy mix. However, doubts should be lessened, as there is a strong and balanced combination of both the ECB aiming at price stability and the Union's strong commitment to budgetary discipline in Europe. If major partners in addition seek sensible policies, the result should be a stable euro.⁸³

⁸¹ EURO PAPER 1. *External Aspects of the European Union.*

Internet website address: <http://europa.eu.int/euro/en/External/extern.asp?nav=>

Last update: 29/04/97.

⁸² EURO PAPER 17. *The Euro: Explanatory Notes.*

Internet website address: <http://europa.eu.int/euro/default.asp?lang=en>

Last update: 11/03/98.

⁸³ EURO PAPER 1. *External Aspects of the European Union.*

Internet website address: <http://europa.eu.int/euro/en/External/extern.asp?nav=>

Last update: 29/04/97.

CHAPTER 10: Rhone-Poulenc Group Euro Case Study

Purpose

This case study examines the process the Rhone-Poulenc Group (RPG) followed in converting their company to the euro. The RPG wanted to participate in the euro case study to see how the euro would affect its company in operational terms and consequently find what sort of recommendations may be needed to successfully implement the new currency into the business environment. In addition, the findings from this study would hopefully benefit other businesses and organizations to ensure the euro conversion would take place smoothly and efficiently.

Background of RPG

RPG is one of the world's leading life science companies and has over 68,000 employees in over 160 countries. The company leads the business in pharmaceuticals and is the number one provider of human vaccines and immunology research and development. Its revenue is divided across 3 main continents: Europe (which maintains about 50 percent), North America (25 percent) and Asia (10 percent). The other 15 percent of the revenue are maintained in other parts of the world.

RPG is very decentralized as many of its subsidiaries acts as fully independent medium sized companies. The company is also decentralized in its information systems. The following is the process that Rhone-Poulenc followed over the next two years in anticipation of the euro.

The analysis of the euro at RPG started in May 1996. The project was initiated by the backing of its CEO, Jean-Rene Fourtou. The project consisted of various departments that included Finance, Tax, Law, Human Resources and Information Technology (IT). From May to October of the same year, the team evaluated the impact of the EMU and the euro on its support services. They concluded that the operational areas of the business would be most affected, so recommendations were made that representatives from these areas should be brought into the project to help advise on the new implementation process of the euro. The team also found that the overall impact of the euro would be most affected in general businesses (40 percent), Information Technology (40 percent), and other functions (20 percent).

From November 96 to June 1997, the project was split into eight decentralized teams with separate project leaders. Each team had to determine when the euro had to be implemented into various operational systems, such as accounting and software systems. They had to assess what kind of impact the euro would have on these type of systems, and how much it would cost to have these changes implemented.

In June 1997, important findings from the eight groups were presented to the board in a document that laid out different strategies for integrating the euro successfully into their operational systems. The document concluded that implementing the euro was more than just a technical impact to the systems. It was an impact to the whole business arena, where transaction costs, exchange rate certainty and prices transparency would sharpen

European market-place competition. Furthermore, the groups suggested that the change over to the euro should be capitalized upon as quickly as possible.

From October 97 to the present, the strategic document was approved by the Executive Board. During this time, commitments were made which included the conversion of taxation, payroll and finance systems to the euro no later than December 1999, and that banking requirements e.g. electronic funds transfers, would be seen as high priority during the transition process between 1999 and 2002. Customers and suppliers would also drive this transitional process.

Rewards

RPG wanted to switch over to the euro in order to take advantage of opportunities that includes price transparency, invoicing and the positive effects of the new currency. In regards to price transparency, it is expected that it will have a major impact on sales. Many pharmaceutical products are sold at different prices in different countries. Therefore, by switching over to the euro quicker than its competitors, RPG would be able to retain and increase its market base.

In terms of invoicing, customer service will be emphasized if full support for the euro is provided. RPG will be sensitive and responsive to customers who are to be invoiced in the euro. Finally, RPG will have a competitive advantage if it moves to a strong currency right away as opposed to other businesses that are just beginning to prepare for the euro.

Keys to Success

One major key in determining RPG's success is communication with other business partners and its clients. RPG will have to keep their customers and potential buyers well informed of the progress of the euro implementation in their operational systems. In addition, RPG will have to determine whether customers could handle orders in the new currency. They can do so by managing the switchover process on a customer by customer basis and determining what their needs are during the transition phase.

Main Challenges

There will be many challenges for RPG with the switchover to the euro. During the study, it was discovered that the changeover to the Euro was a challenge not only to the company but also to the whole business landscape. Therefore, RPG will have to work with and analyze other companies to determine how they are proceeding with the euro and how those businesses are successfully implementing the new currency in their own operational systems.

In addition, the RPG groups have found that the complexity of the changeover process has been underestimated in their company, as many of those in the lower-level positions view the transition as simply pressing a button. What needs to be achieved is an implementation of a thorough communications program, where people from all levels of the company will be aware of exactly how the company and business arena will be affected by the introduction of the euro. Finally, RPG should keep other options and

strategies available of implementing the euro, as possible late decisions by the government on regulations and plans may make progress more difficult.⁸⁴

⁸⁴ European Commission. *A Case Study on the Business and IT Dimensions of Conversion to the Euro at Rhone-Poulenc*. Eur-op (EC's Publications Office): Advanced Information Databases Inc. 23205 Gratiot Avenue, Eastpoint, MI 48021.

Part 4: The United Kingdom

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CHAPTER 11: Steps towards UK Membership

In this section, I will focus on the debate in the UK on whether the country would benefit from joining the EMU. I plan to concentrate on the economic arguments, and begin with the history and steps towards UK membership of the European Union from the 1950s until today.

Process

The United Kingdom was initially opposed to joining the European Community when it was first established in the 1950s. This reluctance primarily was rooted in political reasons, as it was thought that membership might weaken Britain's stance in the international arena. At the time, Britain was concerned with its own strong political ties to the United States and economic ties to the Commonwealth. There was also opposition and skepticism from many who saw the membership as giving up power to an outside body, which implied the loss of national sovereignty.

In 1959, the United Kingdom, along with Norway, Sweden, Denmark, Austria, Portugal, Iceland, Switzerland and Finland as an associate member, created the European Free Trade Association (EFTA). As a free trade area, the EFTA would involve no sacrifice of national sovereignty. However, Britain realized that isolation from the Community would mean that it risked economic and political separation with the latter. Nevertheless, it took close to fifteen years and many negotiations before Britain actually

joined the EC in 1973.⁸⁵ Below is a closer examination of steps towards UK membership after the EFTA was created.

In 1961, the six original members signed The Treaty of Rome in 1957. Four years later, the United Kingdom applied for membership. In addition, Ireland and Denmark also submitted applications, followed by Norway in 1962. The following year, in 1963, negotiations over British membership took place when President de Gaulle of France vetoed the United Kingdom application. This act caused negotiations with all the applicants to be stopped, as did again in 1967, when the French refused to allow negotiations when the four applicant countries tried again to be part of the original six.⁸⁶

Finally, in 1973, after further successful negotiations, the United Kingdom, Ireland and Denmark joined the Community on January 1 of that year. However, Norway did not join because a majority of its people voted against it in a referendum. Additionally, in 1975, a referendum was held in the United Kingdom, which confirmed its membership.⁸⁷

Despite its earlier persistence to become part of the Economic Community in the 1960s and 1970s, Britain will not be a part of European economic and monetary union when it starts in January 1999. On October 27th, 1997, the UK Chancellor, Gordon

⁸⁵ European Commission. *History of UK Membership of the EU*.
Internet website address: <http://www.cec.org.uk/offices/history/htm>.

⁸⁶ European Commission. *History of UK Membership of the EU*.
Internet website address: <http://www.cec.org.uk/offices/history/htm>

⁸⁷ European Commission. *History of UK Membership of the EU*.
Internet website address: <http://www.cec.org.uk/offices/history/htm>.

Brown, made a series of important statements that effectively ruled out British membership in a single European currency before the next election (due by June 2002).⁸⁸ On January 5, 1998, the British Government reaffirmed this stance.

However, the Chancellor also conversely stated that “the potential benefits for Britain of a successful single currency are obvious: in terms of trade, transparency of costs and currency stability. . . So in principle, a successful, single currency within a single European market would be a benefit to Europe and to Britain... If, in the end, a single currency is successful, and the economic case is clear and unambiguous, then the Government believes Britain should be a part of it.”⁸⁹ This statement implies that the Government supports the principle of joining the single currency. It is also important to note that Britain will only go ahead with EMU if it is in the national interest of the country. If this were to be the case, the British people would have the final say in a referendum.⁹⁰

If Britain does decide to join the single currency, there are few determining factors to consider first:

- The decision on British participation in the single currency is one for the British Government and the British people alone. Any Government decision to join the

⁸⁸ Preston, Robert. (October 28, 1997). UK ‘will not join EMU before 2002.’ *The Financial Times Limited*. Front page, first section.

⁸⁹ Euro: Get ready for the euro on 1 January 1999. (September 1998). *The UK Position on EMU*. Official UK Government website for the euro: Internet website address: <http://www.euro.gov.uk/will/time.html>.

⁹⁰ HM Treasury, Euro Preparations Unit. (September 1998). *Local Government Preparations for the euro*. Internet website address: <http://www.euro.gov.uk/>.

euro at a future date will be based on what is in the national economic interest. All of the main political parties would have to agree to such a decision, whereby it will be then approved and legitimized by a referendum of the British people.

- The Government's central economic objective is to achieve high and stable levels of growth and employment. Britain's economic interests in the single currency need to be judged against this central objective. To make this assessment, the Government will examine the following questions before Britain considers entry into EMU:

1. Are business cycles compatible so that the British citizens could live comfortably with euro interest rates on a permanent basis?
2. If problems emerge, is there sufficient flexibility to deal with them?
3. Would joining EMU create better conditions for firms making long-term decisions to invest in Britain?
4. What impact would entry into EMU have on the competitive position of the UK's financial services industry?
5. Will joining EMU promote higher growth, stability and a lasting increase in jobs?⁹¹

⁹¹ HM Treasury, Euro Preparations Unit. (October 1997). *UK Membership of the Single Currency: An Assessment of the Five Economic Tests*.
Internet website address: <http://www.euro-emu.co.uk/pubs/index.html>

In addition, as already mentioned in Chapter 4, five economic conditions were embedded in the Maastricht Treaty to ensure the economies of member states were convergent so that not one member could jeopardize the system. If Great Britain decided to join the single currency, the country must accept and satisfy the five conditions:

1. **Government Debt-** On the state finances, Government borrowing must not exceed 3 percent of gross domestic product (GDP)- the size of the economy - while gross government debt should be no more than 60 percent of GDP.
2. **Government Deficit-** National state deficits must be below 3 percent of the Gross National Product (GNP).
3. **Long term interest rates-** A member state must have an average long-term interest rate that does not exceed by more than 2 percent that of the three best performing member states.
4. **Inflation-** Percentage of inflation cannot exceed 1.5 percent of the average percentage of the three members that have the lowest inflation.
5. **Exchange Rate Stability-** On exchange rates, each currency must observe the "normal fluctuation margins" within the Exchange Rate Mechanism. A national currency cannot have been undervalued within the last two years and must remain in the fluctuation region of 2.5 percent. But as sterling crashed out of ERM six years ago, it is unclear where the UK would have to rejoin the mechanism before qualifying.

CHAPTER 12: UK and EMU

It is difficult to balance the potential costs and benefits of joining EMU for Britain, since there are so many different factors to consider in the economic arena. Britain would have to consider the difficulties of facing by itself, such as a sensitive economy and changes in its interest rates. At the moment, many believe that Britain is not ready to join because it is too far out of step with the rest of continental Europe for the reasons mentioned above. However, given popular support for a well-planned venture, it may be suitable for Britain to join the EMU.

Some think that if the UK joined the EMU, it would increase the credibility of monetary policy compared with the present arrangements in the UK. However, there is no certainty that a single currency would necessarily have a better inflation record than some of the major EU countries, and it is still rather early to assess the new monetary policy regime in the UK. Moreover, it is by no means certain that a move to a single currency would lead to a significant gain in the credibility of UK monetary policy over what would be achievable outside of EMU. And if the UK does choose to join, changes will have to take place, such as its government granting a greater degree of independence to the central bank or to form some type of exchange rate link with the monetary union.

Furthermore, if the UK were to join, there might be some reasons to shorten the changeover timetable, instead of prolonging the schedule. Some reasons are that the euro will already be a currency and the ECB will already be in operation. Also, some UK

businesses will already have the experience of using the euro and if the UK were to join after January 1, 2002, euro banknotes and coins would already be legal tender in other European countries, and it might be used to a restricted extent in the UK.⁹²

Advantages to Join EMU

EMU can be seen as attractive to the UK, provided that the UK moves towards a European pattern in regards to market structures, institutions and regulations. Supporters of EMU see that non-participation would weaken Britain's voice in the global arena of international organizations, such as the free trade negotiations under the World Trade Organization (WTO).⁹³

In addition, Britain's reluctance to partake in the single currency could have serious aftereffects for businesses, consumers and homeowners, as the British Government would not be prepared to rule out devaluation of the pound sterling or to accept the regulation of a strong and stable currency. This would correspondingly demand higher interest rates to insure themselves against the risk of devaluation or depreciation.⁹⁴

⁹² Euro: Get ready for the euro on 1 January 1999. (September 1998). *The UK Position on EMU*. Official UK Government website for the euro: Internet website address: <http://www.euro.gov.uk/will/time.html>.

⁹³ The European Commission Representation in the UK. (February 1997). *European Monetary Union and the euro*. Internet website address: <http://www.cec.org.uk/pubs/brief/brief04.htm>

⁹⁴ The European Commission Representation in the UK. (February 1997). *European Monetary Union and the euro*. Internet website address: <http://www.cec.org.uk/pubs/brief/brief04.htm>

Disadvantages of EMU Membership

With a single currency, individual countries are deprived of the means to prevent progressive divergence with high and growing unemployment. Therefore, joining EMU may be a mistake because floating exchange rate regimes offers greater stability for the UK at present, and because the loss of monetary independence could seriously hinder adjustment to certain shocks. In addition, participation in a single currency can be seen as the end of national sovereignty and the end as an independent nation, as Britain's taxpayers may have to be asked to pay for any other Members' economic problems within the single currency area.⁹⁵

Advocates and Non-advocates

Despite the opposing views of those who believe that the EMU will do more harm than good to the UK, a number of UK business leaders have ignored the advice and criticism, and instead have joined their European counterparts by endorsing membership in a single European currency. For example, the Europe Business Monitor found that 65 percent of UK directors questioned were personally in favor of joining EMU and only 11 percent felt participation would be bad for their companies. The UPS Europe Business Monitor additionally stated that 57 percent of Britain's biggest companies were prepared to do business in the Euro.⁹⁶

Presently, Britain's oldest and most influential lobbying group, the European Movement, advocates that the join of EMU would be beneficial for the nation. It has

published a document in August that lays out a strategy for a referendum on advocating the Euro. However, the British government itself has put the issue aside, and simply states that Britain will most probably go forth with the euro when it benefits the nation economically.

Additionally, inside the government, there are those that are advocates of an economically integrated Britain with the rest of the Members of EMU. These people are anticipating and working towards a more definite timetable, and are expecting a referendum to be called soon after a second Labor election victory, which is predicted to be in the year 2001. If that should occur, the government is expected to be behind a full “Yes” campaign of joining the single currency.⁹⁷

The Yes campaign is headed by the Minister of the Department of Trade and Industry, Lord Sainsbury, who is incidentally the European Movement’s chief financial banker, and by a former vice-chairman of the Movement, Peter Mandelson. It also has the backing and support of the Trades Union Congress, the Confederation of British Industry (CBI) and much of the financial city of London. Additionally, the Yes campaign also has the support of British Petroleum, whose policy leader, Nick Butler, has attended meetings in the past.⁹⁸

⁹⁵ The European Commission Representation in the UK. (February 1997). *European Monetary Union and the euro*. Internet website address: <http://www.cec.org.uk/pubs/brief/brief04.htm>.

⁹⁶ *The Economist*. (August 8, 1998). Britain: Under Starter’s Orders. V: 348, No. 8080, pp. 47-48.

⁹⁷ *The Economist*. (August 8, 1998). Britain: Under Starter’s Orders. V: 348, No. 8080, pp. 47-48.

⁹⁸ *The Economist*. (August 8, 1998). Britain: Under Starter’s Orders. V: 348, No. 8080, pp. 47-48.

The Yes movement's strategy is to publicly campaign about the benefits of participating in the single currency. The plan is to present an "agreed, coherent message" with the aim of establishing "a measurable majority of the public who favor British participation." The message may be difficult to deliver, since the majority of the population is opposed to the idea of their country joining the euro. In addition, inside the government, the Treasury also participated in euro campaigning by advertising about the currency's launch. The department says that the campaigns are only designed to provide the public with political education.⁹⁹

There is opposition to the Yes campaigns, both inside and outside the government. There are presently about 30 anti-European movement groups, including an Euroskeptic's cricket team. These movements aim at establishing plans of action and defense for stopping Britain from joining the single currency. One of the more popular groups is the Business for Sterling (BFS), which was officially launched on June 11th, 1998.¹⁰⁰

One of the main objectives for BFS is to draw serious money and investment from businesses and companies, consequently going economically against the euro. A former Labor minister, Richard Marsh, heads BFS. The group is financially backed up and supported by many prominent businessmen, including Sir Stanley Kalms, the chairman of

⁹⁹ *The Economist*. (August 8, 1998). Britain: Under Starter's Orders. V: 348, No. 8080, pp. 47-48.

¹⁰⁰ *The Economist*. (August 8, 1998). Britain: Under Starter's Orders. V: 348, No. 8080, pp. 47-48.

Dixons, a British electronic goods supply company. Other business supporters of BFS are McAlpines, a construction dynasty and Lord Wolfson of Great Universal Stores.¹⁰¹

The biggest help for the “No” campaigners is Britain’s best selling national newspaper, *The Sun*, which is also supported by the Murdoch press and the Daily Telegraph. “83 percent of *Sun* readers opposed a single currency, as showed by recent MORI poll.”¹⁰² These statistics shows that are strong links between the anti-European media and the BFS. And it is not coincidence that Lord Marsh, the leader of BFS, is a former chairman of the Newspaper Publishers’ Association, who also has known both Mr. Murdoch and Conrad Black, the owner of the *Daily Telegraph*, for many years.¹⁰³

Furthermore, the UPS survey interviewed nearly 1,500 directors from Europe's top 15,000 companies. It found that the UK is still more skeptical of monetary union than other European countries. In addition, a recent survey on the Federation of Small Businesses showed that 75 percent of its 120,000 members are opposed to Britain joining the euro.¹⁰⁴ This is tied into UK doubts about EMU membership that is linked to a significant level of skepticism about the strength of the euro’s launch.

The question now is which group is going to win in the struggle of economic integration or continuous economic isolation. British attitudes towards the euro remain identical to what they were six years ago. According to a MORI poll in November 1991,

¹⁰¹ *The Economist*. (August 8, 1998). Britain: Under Starter’s Orders. V: 348, No. 8080, pp. 47-48.

¹⁰² *The Economist*. (August 8, 1998). Britain: Under Starter’s Orders. V: 348, No. 8080, pp. 48.

¹⁰³ *The Economist*. (August 8, 1998). Britain: Under Starter’s Orders. V: 348, No. 8080, pp. 47-48.

¹⁰⁴ *The Economist*. (August 8, 1998). Britain: Under Starter’s Orders. V: 348, No. 8080, pp. 47-48.

it showed that 54 percent were against joining; the figure today is virtually identical. But these types of polls should not reflect how voting on a referendum will turn out. After all, the Prime Minister and many of the big businesses are behind the single currency and the Yes campaign.

CHAPTER 13: UK's Situation as an Investment Location

The UK benefits substantially from foreign direct investment and takes a large share of investment from countries both within and outside Europe. In fact, foreign investment has not been discouraged by the UK's hesitant approach towards both the ERM and monetary union. Instead, the most important advantage for the UK in this stance is that it remains a competitive location for business. It remains so because the UK has strengths that continue to attract foreign investors, such as good industrial relations, low company taxes, a skilled labor force and communication in the most popular language in the world: English.¹⁰⁵

Conversely, disadvantages for the UK by not participating in the EMU could be viewed as having a less central role and decision-making influences in Europe, which could well deter foreign investment. In addition, the non-participating stance could imply to outsiders that the nation has an unsteady and shaky relationship with the single market and would be seen as moving away from mainstream European economics. This could well dissuade possible foreign investors.

UK businesses that most likely will be affected by the introduction of the euro are exporters and importers. UK exporters are likely to come under pressure, as they may have to begin quoting in euro as well as the traditional quotes of sterling.¹⁰⁶ Furthermore,

¹⁰⁵ The European Commission Representation in the UK. (February 1997). *European Monetary Union and the euro*. Internet website address: <http://www.cec.org.uk/pubs/brief/brief04.htm>.

¹⁰⁶ Euro: Get ready for the euro on 1 January 1999. (September 1998). *The introduction of euro and the implications for the UK*. Official UK Government website for the euro: www.euro.gov.uk/fact4.html

the companies that will be most affected by the decision not to join EMU will be those that deal with EU financial markets and with European customers, contractors and suppliers.¹⁰⁷

If the UK pursues membership in the EMU, banks and businesses would likely contribute actively to the success of the introduction of the single currency by adapting their internal organizations, products and services and informing their staff and their customers. This type of adaptation of business will provide for a satisfactory return on investment, and the extent of adaptations would be closely linked to the size and international exposure of the company. Small companies will also benefit from the expertise of larger ones who will implement changes at an earlier stage.

There are several approaches in which businesses and firms can begin to adapt the euro. Possible approaches include the early start collection of information, setting up an euro platform, defining a changeover strategy, and implementing these changes. These targets should be seen as a major project. It is also important to note that for businesses, there are risks in starting preparations too early, but there are still greater risks in delaying preparations.¹⁰⁸

¹⁰⁷ The European Commission Representation in the UK. (February 1997). *European Monetary Union and the euro*. Internet website address: <http://www.cec.org.uk/pubs/brief/brief04.htm>.

¹⁰⁸ HM Treasury, Euro Preparations Unit. (September 1998). *Local Government Preparations for the euro*. Internet website address: <http://www.euro.gov.uk/>.

London: Losses and Gains

Another factor that needs to be considered is what kind of effects UK's position on EMU might have on its financial markets and on the international standing of London as a major European financial center. In addition, since Germany and France will adopt the euro, there is some speculation that London may suffer as a major financial center.¹⁰⁹ Consequently London would face intense competition from Frankfurt¹¹⁰ and Paris, as the main money markets might develop further in these cities and would be at advantage over London for the new single-currency business.¹¹¹ For instance, stock exchanges in Frankfurt are considered to be among the most dynamic and forward-thinking in Europe, extending over London.¹¹²

There is additional speculation that London will undoubtedly suffer as a major financial city since it handles most of the European foreign exchange trading, which is expected to decrease as European currencies disappear. In addition, London may fade when the euro is introduced because European banks will shift their business and exchanges from London back to their own domestic home bases, according to Michel Fleuriet of Merrill Lynch in Paris.¹¹³ This shift will occur primarily to hold on to tighter controls "on risky trading and investment businesses."¹¹⁴

¹⁰⁹ Edwards, Ben. (May 9, 1998). Survey: Financial center: Euro-neurosis. *The Economist*. V: 347, No. 8067, pp. S15-S22.

¹¹⁰ The new European Central Bank will be located in Frankfurt.

¹¹¹ The European Commission Representation in the UK. (February 1997). *European Monetary Union and the euro*. Internet website address: <http://www.cec.org.uk/pubs/brief/brief04.htm>.

¹¹² Edwards, Ben. (May 9, 1998). Survey: Financial center: Euro-neurosis. *The Economist*. V: 347, No. 8067, pp. S15-S22.

¹¹³ Edwards, Ben. (May 9, 1998). Survey: Financial center: Euro-neurosis. *The Economist*. V: 347, No. 8067, pp. S15-S22.

Additionally, London will most likely be at a disadvantage because it will lack inside information from the euro area. According to Mr. Bordenave of BNP, “London will get a second-hand perception of what’s happening in Euroland. London won’t get the information as quickly and, in our business, even a few seconds are important.”¹¹⁵

Likewise, Frankfurt and Paris will be at an advantage because they will be in the center of all euro-related business activities, hence being a step ahead of London in Europe. In addition, having the ECB’s headquarters right in Frankfurt boosts the city’s step towards a major financial district city.

Yet, this last point may be proven otherwise, since New York City is still a leading financial center while the Federal Reserve is based in Washington. Also, nowadays there is amazing computer technology where data can be exchanged and distributed at any one time. This type of exchange facilitates policy and monetary making decisions, where a financial center such as London will have the full benefits of obtaining and exchanging information with that of other euro financial centers. Moreover, there are many foreign investment banks that have their headquarters located in London, such as Merrill Lynch and Morgan Stanley, which helps to stabilize the fears of London losing out as a financial center.¹¹⁶

¹¹⁴ Edwards, Ben. (May 9, 1998). Survey: Financial center: Euro-neurosis. *The Economist*. V: 347, No. 8067, pp. S15-S22.

¹¹⁵ Edwards, Ben. (May 9, 1998). Survey: Financial center: Euro-neurosis. *The Economist*. V: 347, No. 8067, pp. S15-S22.

¹¹⁶ Edwards, Ben. (May 9, 1998). Survey: Financial center: Euro-neurosis. *The Economist*. V: 347, No. 8067, pp. S15-S22.

Another benefit for London is its commercial law. British commercial law is not codified, allowing it to handle the pace of financial changes better than laws that are codified, such as France or Germany's laws. The "uncodified" systems will actually help London make adjustments that are necessary to keep up with euro changes that may be faster and better than members of EMU.

Part 5: Conclusion

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CHAPTER 14: Challenges for the EMU in the future

EMU was established as a European economic alliance in the hopes of strengthening the economic and political collaboration around the area. It was the grand finale of the economic recovery process that soon started after the Second World War. At that time, regional leaders wanted to invigorate the power of an economic alliance to stabilize and decrease the possibilities of war and hostilities.

I believe that if used appropriately, EMU can pave the way for the return to economic stability, prosperity, and growth, as it intends to promote development in all areas. These developments in turn can give the European community the chance to fight against unemployment and to raise the standard of living. In addition, internal conflicts would have to be decreased in order for the member and potential member states to genuinely share the bond that will tie them together- monetary and economic trust.

The effects of monetary unification will depend on how well it is structured and governed, and how quickly Europe's markets adapt to a single currency. The process of monetary unification will not end in 1999 or 2002; rather, the structure and operation of Europe's monetary union probably will continue to evolve for years to come, allowing the well being and growth to continue and increase along the way.

The future will only remain clear for Continental Europe if the various countries of the region pursue the same routes and goals towards economic globalization, and if they have popular support from the people. If these goals are met, then Europe will

approach a historic and monumental stepping stone when its economy will become integrated into one. The question now is whether the steps towards the integration process of European Monetary Union will be a smooth transition for many of the Member countries.

The transition process involves allowing European countries to move at different paces. The idea is for the main, core states to go ahead and participate fully, while the weaker states will follow when they were capable and strong enough to handle the integration (that is, when they meet all the criteria set forth by the Maastricht Treaty). However, some are skeptical that this process may not be even and smooth as anticipated, as Eastern Europe needs more time and financial aid for reformation and rebuilding in comparison to other Western European states. As a consequence, European resources will most likely be taxed by these reconstruction charges. Obviously this will slow the pace and transition process of the EU integration.¹¹⁷

EMU has some down sides as a player of a major regional trading bloc. One significant issue is that it depreciates important issues such as unemployment, as it still is a major problem in Europe, and could even well possibly intensify in some parts of the EMU zone. High unemployment could be caused in EMU by the loss of exchange rate flexibility and the constraints placed on the elasticity of national fiscal policy. However, given time, change could be forced upon the ECB to take action as its position could be minimized by the high unemployment problem.

¹¹⁷ Hufbauer, Gary Clyde. (1992). *Europe 1992, An American Perspective*, p.18.

Moreover, there is some concern by skeptics that EMU may influence national sovereignty and that that will be a further step towards a federation of Europe. That may be true, but it is important to note that members of the EU have considerable choice as to how far it goes towards a federal Europe. The choices are secure, as the central bank of every participating country will have a say in the formulation of monetary policy.¹¹⁸

The direction that European leaders take to meet these challenges will shape the future of the EMU and EU. If they don't respond to challenges, this may create pressures at the national level, which consequently could push the ECB into instituting an unrestrained monetary policy, which may result in higher inflation and consequently have an opposing effect on the economy. These negative changes could ultimately ruin the EMU.

Leaders can avoid this unbalanced and insecure route if they respond to challenges in a thorough and timely manner through successfully implement reforms that support a cultivated monetary union. The future of the EMU depends upon the ability of these leaders to address these issues. It will take well-organized collective effort if they are intent on making EMU succeed. Moreover, public debate should be encouraged so that leaders will be well aware of issues that troubles the average citizen and therefore can address and respond to their concerns in order for popular support not to be lost within the union.

A Political Union Forecasted as Well?

A fundamental long-term effect of adopting a single currency may be the creation of a political union, where a European federal union would be responsible for a Europe-wide foreign and security policy as well as for what are now domestic economic and social policies. While some individual governments and key political figures differ in their reasons for wanting a political union, the intent is there to those that desire to have a complete bureaucratic union.

However, the possibility of creating a political union from a monetary one is not that considerable in my view. By adopting the single currency, it means surrendering national control over monetary policy, yet, that does not imply that there will be a further loss of national sovereignty. Indeed if European governments have to choose whether or not to have a political union, participating in EMU does not pre-ordain that decision. Both unions entail different goals and regulations, and can operate on separate grounds. Moreover, the extent to which a political union can become a reality in the future remains essentially a matter of political choice among the leaders and the people.

If a political union were to come out of EMU in the distant future, there are many issues that may come into conflict with each other. Main issues that can come into conflict among the EMU members are disagreements over power and disputes over domestic and international policies. These disputes may arise from previous ones that

¹¹⁸ The European Commission Representation in the UK. (February 1997). *European Monetary Union and the euro*.

pertained to manners and methods of implementing and conducting monetary policies within the union. Consequently, these animosities would most likely cause general distrust among the European leaders and its people.

In addition, since probably not all European nations would be part of a monetary and political union, there would be potential conflicts and differences between members and nonmembers within Europe, including the states of Eastern Europe and the former Soviet Union, on political stances. Conflicts could also develop between a European political union and non-European nations over issues of foreign policy and international trade.¹¹⁹

Although it is impossible to know for certain whether these conflicts could lead to greater hostilities such as war, it is apparent by examining these possible issues that a political union would not be conceivable or recommended for Europe in the future. As the devastating American Civil War showed, a formal political union is no guarantee against wars within Europe, contrary to the hopes and assumptions of Monnet and other advocates had about European integration. EMU stands for monetary policy and not for anything else.¹²⁰

Great Britain

The British economy has gone through a roller-coaster path of ups and downs, notably in the last twenty years. By the early 1980s, a recession had taken place, and by

the late 1980s, the economy went through a period of boom, but unfortunately this was followed by more inflation and recession. Presently, after six years of expansion and growth, the economy unfortunately seems to be headed toward another sharp dip in growth, and economist even predict perhaps a recession by next year. Recession is anticipated due to factors such as weak manufacturing and lack of confidence in business and consumer affairs.¹²¹ The lack of confidence is due to a slowing economy and high inflation.

The British government would need to have a clear focus of what it wants in the near future in the economic arena. As the euro begins to spread its wings with its neighbors, Britain will have to look and examine its own history and economy and see if it will fare better inside EMU or out of it. Suppose that Britain's economy does sink into recession next year and unemployment rises. Meanwhile, the recovering economies of Germany and France will hopefully look strong during the early days of monetary union, maintaining strong growth and decreasing unemployment. This will encourage arguments from those who believe it is in the best interests of the British economy to join EMU as soon as possible.

In addition, presently businesses in the UK pay higher interest rates than in many other EU countries, mostly in part that holders of sterling insisting on a premium to insure them against the possibility of devaluation. With a single currency, that likelihood

¹¹⁹ Feldstein, Martin. (Nov/Dec 1997). EMU and International Conflict. *Foreign Affairs*. V: 76, No. 6, p. 62.

¹²⁰ Feldstein, Martin. (Nov/Dec 1997). EMU and International Conflict. *Foreign Affairs*. V: 76, No. 6, p. 62.

¹²¹ *The Economist*. (July 25, 1998). Leaders: Britain's next recession. V: 348, No. 8078, p. 20.

of that happening would no longer exist.¹²² However, only the people of Britain can tell and decide if their country will be part of the single currency in the near future. At the moment, given Britain's wobbly economic path that is out of sync with the rest of Continental Europe's, this just accentuates the difficulties that Britain faces as it decides whether the euro will be part of its economy and society.

Preparations by Governments, Businesses and Organizations

People across the globe will have to face challenges and new ventures when the euro is introduced early next year. The eleven countries that are already a part of EMU will be profoundly affected by the new single currency, and they are preparing for the introduction by businesses and organizations by turning to their respective governments for information and help. Governments can provide aid by providing key information to organizations that will enable them to plan for the launch of the single currency. They can do so by maintaining awareness campaigns, setting up euro websites on the Internet, setting up information telephone lines (euro hot-lines) and producing public factsheets that have detailed thematic information on the implications of the euro.

¹²² The European Commission Representation in the UK. (February 1997). *European Monetary Union and the euro*. Internet website address: <http://www.cec.org.uk/pubs/brief/brief04.htm>.

In addition, governments can extend their consultation framework to involve appropriate players at the regional as well as national level. Consultation efforts can include involving structures that provide a central point of contact between business and government on practical single currency issues, that basically acts as a central information source.

The ways in which organizations and businesses can help themselves to adapt easier to the euro is to monitor the extent to which the euro will be used in their economies, and to manage the ways in which they can be flexible in responding to the changing business environment. Fundamental changes in the business landscape includes cheaper transaction costs, exchange rate certainty and price transparency that will definitely sharpen the European market-place competition.

In conclusion, the future of all the aspects of the European economic community, naturally encompassing EMU, will rest upon the will and intent of the people. This implies that the future of EMU will also rest upon the UK's and Denmark's decision to join EMU or not. At the moment, both countries seem opposed to the new single currency and their stances may influence the direction the EMU takes in the future.

For the participating member states in the EMU, it is up to them to foresee how well the euro will be implemented, and in what direction the integration process will head towards. All the necessary action and goals can only be successful if the mass approves and supports the new monetary union. This may be difficult, as Europe is divided by the

diversity of its economies and even greater diversified by its social and political organizations and institutions. How well the EMU will respond to these pressures and challenges will determine the future course of European integration.

As stated above, governments are already performing valuable deeds by preparing and aiding both the private and public sector for the launch of the euro. The governments will have to continue to do so in order for the people to be well informed and to be well prepared for it. Without ample preparations, Europe will not be ready for a full monetary union, and may set back the timetables and schedule of a converging European economy.

Furthermore, the necessary groundwork will have to proceed in order to gain popular support among the people. Popular support can be strengthened by public debate and by leaders addressing their concerns and interests in a proficient and rational manner. Without popular support, integration by any degree cannot take place, and hence, EMU will be in shambles if no one supports its very existence.

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