# European policy decisions of May 1 to 3, 1998 pave the way for the launching of the euro on January 1, 1999

From May 1 to 3, 1998, the Council of the European Union, meeting in Brussels as the Council of Ministers and in the composition of the Heads of State or Government, took some important decisions with respect to the start of Stage Three of European economic and monetary union (EMU) on January 1, 1999. Some of the deliberations were attended by the Governors of the EU central banks and the President of the European Monetary Institute (EMI). The following article, which continues the Bundesbank's reports on the preparations for economic and monetary union,[1] provides an overview of the decisions taken. Following the decisions detailed below and the adoption of the statutory framework for the euro in accordance with Article 109 l (4) of the EC Treaty and of the Regulation on the denominations and technical specifications of the euro coins intended for circulation, the road to monetary union is now clearly mapped out.

1 Cf. Deutsche Bundesbank, The first stage of European economic and monetary union, Monthly Report, July 1990, p. 29 ff.; Deutsche Bundesbank, Statement by the Deutsche Bundesbank on the establishment of an Economic and Monetary Union, Monthly Report, October 1990, p. 40 ff.; Deutsche Bundesbank, The Maastricht decisions on European economic and monetary union, Monthly Report, February 1992, p. 43 ff.; Deutsche Bundesbank, The continued validity of the Deutsche Mark and its replacement at a later date by a single European currency, Monthly Report, February 1992, p. 53 ff.; Deutsche Bundesbank, The second stage of European economic and monetary union, Monthly Report, January 1994, p. 23 ff.; Deutsche Bundesbank, Scenario for the changeover to the single European currency, Monthly Report, January 1996, p. 53 ff.; Deutsche Bundesbank, Opinion of the Central Bank Council concerning convergence in the European Union in view of Stage Three of economic and monetary union, Monthly Report, April 1998, p. 17 ff.

## Selection of the countries participating in the euro area

*Earlier decisions on the existence of excessive budget deficits revoked*

On May 1, 1998, the Council of Ministers, acting on the recommendation of the Commission and in accordance with Article 104c (12) of the EC Treaty, unanimously revoked its earlier decisions on the existence of excessive deficits in nine member states (Austria, Belgium, France, Germany, Italy, Portugal, Spain, Sweden, and United Kingdom). By stating that the excessive deficits had been corrected, the Council confirmed at the same time that the countries concerned had achieved sustainable public financial positions and had therefore fulfilled a major condition for the introduction of the euro. The Council did not incorporate in its decisions the reservations and concern about some countries expressed in the European Monetary Institute's Convergence Report. An excessive deficit decision by the Council of Ministers still exists only in the case of Greece. However, in a special statement, the Council expressly recognised that Greece had made significant progress in meeting the convergence criteria, and welcomed the Greek government's intention of continuing its policy in the direction of budget consolidation and structural adjustment with a view to being able to join the euro area on January 1, 2001; at the same time, the Council affirmed that, on the date mentioned, the headway made by Greece would be assessed by the same standards applied to the progress made by the member states adopting the single currency on January 1, 1999.

*Even so, further need for consolidation in some member states*

In the texts specifying the revocation of the decisions on the existence of excessive deficits in the aforementioned countries, the Council stated that significant progress had been made in the reduction of general government budget deficits and debt levels. However, not least in the light of the critical assessment made in the EMI's Convergence Report of the fiscal situation and outlook in a number of countries, the Council emphasised in its decisions the Belgian government's undertaking, of its own accord, to maintain a primary surplus of about 6 % of GDP over the medium term, in order to keep the government debt ratio on a sustainably downward adjustment path. With the same objective, the Council registered the Italian government's intention of reducing its debt ratio to below 100 % of GDP by the year 2003.

*Selection of the participants in the euro area depends on compliance with the convergence criteria*

Likewise on May 1, 1998, the Council of Ministers, acting in accordance with Article 109j (2) of the EC Treaty and after taking due account of the Convergence Reports presented by the EMI and the Commission, stated on the recommendation of the Commission that, in its estimation, Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal, and Spain had met not only the fiscal criteria but also the other conditions for participation set forth in Article 109j of the EC Treaty (legal convergence, price and exchange rate stability, and convergence of long-term interest rates) and should therefore introduce the euro as from January 1, 1999. On the basis of this recommendation and of the relevant opinion presented by the European Parliament, the Council, in the composition of the

Heads of State or Government, confirmed on the following day that the member states specified therein fulfilled the conditions necessary for the introduction of the euro as from January 1, 1999. In addition, the Council stated that Greece and Sweden – the latter owing to non-compliance with the criterion of having participated in the exchange rate mechanism for at least two years, and on account of incomplete legal convergence – currently failed to fulfil the conditions for the introduction of the euro. In the case of the United Kingdom and Denmark, the Council conducted no examination of the state of convergence, since both countries had previously declared on the basis of the special regulations granted to them under the Treaty that they did not wish to participate in EMU with effect from January 1, 1999.

### Declaration on budget coordination and on the promotion of growth and employment

*Reaffirmation of existing commitments to preserve financial discipline*

In connection with the selection of the countries participating in EMU, the Council and the ministers assembled in the Council adopted a declaration in which they essentially renewed and amplified the commitments they had entered into in the context of earlier decisions, viz. to consolidate their budgets and foster growth and employment. That declaration was preceded by an initiative on the part of the German Minister of Finance, designed mainly to underpin the existing commitments to fiscal stability, particularly in view of the countries with especially high levels of government debt.

In particular, it was announced in the declaration's fiscal policy section that the Council and/or the member states

– would see to it that the national budgetary objectives set for 1998 would be achieved unreservedly and that, if necessary, corrective measures would be taken in good time;

– would examine the member states' budget proposals for 1999 at an early stage, taking due account of the framework and objectives of the Stability and Growth Pact;

– would take the opportunity to step up efforts at budget consolidation if economic conditions developed more favourably than expected, in order to ensure that the medium-term objective included in the commitments of the Stability and Growth Pact, viz. of having a government budgetary position that is close to balance or in surplus, was achieved;

– would have to make all the greater efforts to reduce participating member states' debt-to-GDP ratios, the higher these ratios were. To that end, in addition to achieving appropriate primary surpluses in keeping with the commitments and objectives set forth in the Stability and Growth Pact, further measures should be taken to reduce the gross levels of debt;

– should lessen the vulnerability of fiscal positions through debt management strategies; and

– would undertake to present, not later than the end of 1998, national stability or convergence programmes incorporating these important elements.

*No joint and several liability of the euro countries for the debts of individual states; no financial transfers on account of EMU*

In addition, the Council once again draws attention to the fact that responsibility for budget consolidation will continue to rest with the member states and that, pursuant to Article 104b (1) of the EC Treaty, the Community shall not be liable for member states' commitments. Besides, it is generally agreed within the Council that economic and monetary union as such cannot warrant any special financial transfers among the participating countries.

## Appointment of the members of the ECB Executive Board

*Members of the ECB Executive Board nominated unanimously*

On May 2-3, 1998, after tough negotiations, the Council, in the composition of the Heads of State or Government, also reached political agreement on the make-up of the ECB Executive Board. On this basis, the Council of Ministers elaborated a formal proposal for the appointment of the President, Vice-President, and other members of the Executive Board of the European Central Bank. Now that the European Parliament and the Council of the EMI, which had to be consulted on the appointments, have meanwhile likewise passed favourable verdicts, it is to be expected that the governments of the participating member states, at the level of the Heads of State or Government, will appoint the nominated members of the Executive Board by common accord.

*Conflict over the appointment of the ECB President settled*

On the recommendation of the Council of Ministers, the former Dutch Central Bank Governor and current President of the EMI, Wim Duisenberg, is to be appointed President of the European Central Bank. The Frenchman Christian Noyer (former head of the Treasury in the Ministry of Finance, Economics and Industry) is due to be appointed Vice-President. The ECB Executive Board will be completed by Sirkka Hämäläinen (Governor of the Finnish Central Bank), Otmar Issing (member of the Board of the Deutsche Bundesbank), Tommaso Padoa-Schioppa (head of the Italian stock market supervisory authority), and Eugenio Domingo Solans (member of the Board of the Spanish Central Bank).

*Staggered terms of office in accordance with the contractual conditions*

In accordance with Article 11.2 of the ESCB/ECB Statute, the term of office of the members of the ECB Executive Board shall in principle be eight years. However, Article 50 of the ESCB/ECB Statute provides that, when the Executive Board is first set up, the President shall be appointed for eight years, the Vice-President for four years and the other members of the Executive Board for terms of office of between five and eight years. In later years, this staggering will ensure that one member of the Executive Board will normally retire from office each year, and need to be replaced.

## Advance announcement of the bilateral exchange rates

In addition, the ministers of the member states participating in the euro area, along with those countries' central bank Governors, *Fixing of the conversion rates of the euro based on the ERM central rates*

the European Commission and the European Monetary Institute, reached agreement on a "Joint Communiqué on the determination of the irrevocable conversion rates for the euro". That Communiqué and the notes attached to it are reproduced verbatim in the annex to this article. In essence, it is envisaged that the future conversion rates of the currencies of the participating countries into euros will be based on their current bilateral central rates in the European exchange rate mechanism. At the same time, the central banks involved have agreed to ensure – by appropriate market techniques, if necessary – that the market exchange rates as determined on December 31 will be identical to those central rates. This advance announcement was made for the sake of giving market players some guidance, so as thus to stabilise market expectations and exchange rate movements in the interim stage.

## Outlook

*Improved economic prospects owing to the introduction of the euro*

The agreements reached during the first weekend of May 1998 are major steps on the way to introducing the euro in a number of European countries. The introduction of the euro warrants hopes of tangible economic advantages based primarily on the lowering of transaction costs and the elimination of exchange risk between the participating countries, and, as a concomitant of that, on greater transparency in the merchandise and financial markets involved and on enhanced planning security, especially for the enterprise sector. Over the medium term, the consequent increase in the efficiency of the markets is likely to have a favourable impact on the conditions for growth in the participating countries and, in particular, to improve the efficiency of the emerging euro financial market. A new supranational monetary area is coming into being in Europe, which – in terms of population, national product, foreign trade and financial capacity – stands comparison with any other large monetary area in the world.

The annex to this article appears on the following pages.

# Annex

## I. Joint Communiqué on the determination of the irrevocable conversion rates for the euro

In accordance with Article 109 l (4) of the Treaty, the irrevocable conversion rates for the euro will be adopted by the Council, upon a proposal from the Commission and after consultation of the European Central Bank (ECB), on the first day of Stage Three, i. e. on 1 January 1999.

With a view to guiding markets in the run-up to Stage Three, the Ministers of the Member States adopting the euro as their single currency, the Governors of the Central Banks of these Member States, the European Commission and the European Monetary Institute (EMI) have agreed on the method for determining the irrevocable conversion rates for the euro at the starting date of Stage Three.

The current ERM bilateral central rates of the currencies of the Member States which, on the first day of Stage Three, will adopt the euro as their single currency, will be used in determining the irrevocable conversion rates for the euro. These rates are consistent with economic fundamentals and are compatible with sustainable convergence among the Member States which will participate in the euro area. The central banks of the Member States adopting the euro as their single currency will ensure through appropriate market techniques that on 31 December 1998 the market exchange rates, recorded according to the regular concertation procedure used for calculating the daily exchange rates of the official ECU, are equal to the ERM bilateral central rates as set forth in the attached parity grid.

The procedure agreed upon by all parties to this Joint Communiqué will ensure that the adoption of the irrevocable conversion rates for the euro will by itself, as required by Article 109 l (4) of the Treaty, not modify the external value of the ECU, which will be replaced on a 1:1 basis by the euro. The attached annex provides detailed information on this procedure. The final official ECU exchange rates calculated accordingly and released on 31 December 1998 will be proposed by the Commission for adoption by the Council on the first day of Stage Three, i.e. on 1 January 1999, as the irrevocable conversion rates for the euro for the participating currencies.

In compliance with the legal framework for the use of the euro, once the irrevocable conversion rate for the euro for each participating currency has been adopted, it will be the only rate which will be used for conversion either way between the euro and the national currency unit and also for conversions between national currency units.

## II. Determination of the irrevocable conversion rates for the euro

### 1. Why can only bilateral rates be announced?

Article 109 l (4) of the Treaty provides that the rates at which the euro will be substituted for the currencies participating in the euro area will be adopted at the start of Stage Three of the Economic and Monetary Union, i.e. on 1 January 1999. The adoption of the irrevocable conversion rates for the euro shall by itself not modify the external value of the official ECU. Likewise, Article 2 of the

## ERM bilateral central rates to be used in determining the irrevocable conversion rates for the euro

| Item | DEM 100 = | BEF/LUF 100 = | ESP 100 = | FRF 100 = | IEP 1 = | ITL 1 000 = | NLG 100 = | ATS 100 = | PTE 100 = | FIM 100 = |
|---|---|---|---|---|---|---|---|---|---|---|
| Germany: DEM | – | – | – | – | – | – | – | – | – | – |
| Belgium/ Luxem- bourg: BEF/LUF | 2,062.55 | – | – | – | – | – | – | – | – | – |
| Spain: ESP | 8,507.22 | 412.462 | – | – | – | – | – | – | – | – |
| France: FRF | 335.386 | 16.2608 | 3.94237 | – | – | – | – | – | – | – |
| Ireland: IEP | 40.2676 | 1.95232 | 0.473335 | 12.0063 | – | – | – | – | – | – |
| Italiy: ITL | 99,000.2 | 4,799.90 | 1,163.72 | 29,518.3 | 2,458.56 | – | – | – | – | – |
| Netherlands: NLG | 112.674 | 5.46285 | 1.32445 | 33.5953 | 2.79812 | 1.13812 | – | – | – | – |
| Austria: ATS | 703.552 | 34.1108 | 8.27006 | 209.774 | 17.4719 | 7.10657 | 624.415 | – | – | – |
| Portugal: PTE | 10,250.5 | 496.984 | 120.492 | 3,056.34 | 254.560 | 103.541 | 9,097.53 | 1,456.97 | – | – |
| Finland: FIM | 304.001 | 14.7391 | 3.57345 | 90.6420 | 7.54951 | 3.07071 | 269.806 | 43.2094 | 2.96571 | – |

Council Regulation of 17 June 1997 on certain provisions relating to the introduction of the euro stipulates that every reference in a legal instrument to the official ECU shall be replaced by a reference to the euro at a rate of one euro to one ECU. Therefore, the irrevocable conversion rates for the euro have to be identical to the value of the official ECU expressed in units of the participating currencies on 31 December 1998.

Since the ECU is a currency basket, which includes the Danish krone, the Greek drachma and the pound sterling,[1] it is not possible to announce before the end of 1998 the irrevocable conversion rates at which the euro shall be substituted for the participating currencies. However, it is possible to announce the bilateral rates of the currencies participating in the euro area which will be used on 31 December 1998 in computing the exchange rates of the official ECU and thus in computing the irrevocable euro conversion rates for these currencies.

### 2. Bilateral rates which will be used in determining the irrevocable conversion rates for the euro

For currencies participating in the euro area, the current ERM bilateral central rates will be used in calculating the final official ECU exchange rates which will be adopted by the Council as the irrevocable conversion rates for the euro on the first day of Stage Three, i.e. on 1 January 1999. The table attached to the Joint Communiqué contains those rates. In order to avoid minor arithmetical in-

**1** ECU basket currencies of Member States not participating in the euro area.

consistencies stemming from inverse calculations, it only includes one bilateral rate for each pair of currencies, which will be relevant for the procedure to be followed on 31 December 1998, as described below.

### 3. Calculation of the exchange rates of the official ECU on 31 December 1998

To calculate the exchange rates of the official ECU on 31 December 1998, the regular daily concertation procedure will be used. According to this procedure, the central banks of the Member States communicate the representative exchange rate of their respective currency against the US dollar.

Three steps can be identified.

Step 1:
Determination of the EU currencies' concertation exchange rates against the US dollar

At 11:30 a.m. (CET), the EU central banks, including those with currencies which are not components of the ECU basket, provide to each other in the context of a teleconference, the US dollar exchange rate for their respective currencies. These exchange rates are recorded as discrete values lying within the market bid-ask spreads. While, as a rule, the discrete values are equal to the midpoints of the bid-ask spreads, the EU central banks, as is allowed by the current concertation procedure, will take into account the need to ascertain exchange rates expressed with six significant digits, like for the pre-announced rates. The bilateral rates between the euro area participating currencies obtained by crossing[2] the respective US dollar rates recorded by the EU central banks will be equal to the pre-announced ERM bilateral central rates, up to the sixth significant digit. The EU central banks participating in the euro area stand ready to ensure this equality, if necessary, through the use of appropriate market techniques.

Step 2:
Calculation of the exchange rate of the official ECU against the US dollar

The rates as recorded by the EU central banks are thereafter communicated by the National Bank of Belgium to the Commission, which uses them to calculate the exchange rates of the official ECU. The USD/ECU exchange rate (expressed as 1 ECU = x USD) is obtained by summing up the US dollar equivalents of national currency amounts that compose the ECU.

Step 3:
Calculation of the exchange rates of the official ECU against the EU currencies participating in the euro area

The official ECU exchange rates against the EU currencies are calculated by multiplying the USD/ECU exchange rate by their respective US dollar exchange rates. This calculation is performed for all EU currencies, not only the ones which are components of the ECU basket.

These ECU exchange rates are rounded to the sixth significant digit. Exactly the same method of calculation, including the rounding convention, will be used in determining the irrevocable conversion rates for the euro for the euro area currencies.

For illustrative purposes, the calculation of the official ECU exchange rates vis-à-vis all EU currencies on 31 December 1997 is shown below.

2 For example, FRF/DEM = FRF/USD : DEM/USD.

## Example of the calculation of official ECU exchange rates

| | Step 1 | | Step 2 | Step 3 |
|---|---|---|---|---|
| | Amount of national currency units in the ECU basket | USD exchange rate on 31 December 1997 | Equivalent in dollars of national currency amount | ECU exchange rates |
| Item | (a) | (b) | (c) = (a) : (b) | (d) = (USD/ECU) * (b) |
| DEM | 0.6242 | 1.7898 | 0.3487541 | 1.97632 |
| BEF | 3.301 | 36.92 | 0.0894095 | 40.7675 |
| LUF | 0.130 | 36.92 | 0.0035211 | 40.7675 |
| NLG | 0.2198 | 2.0172 | 0.1089629 | 2.22742 |
| DKK | 0.1976 | 6.8175 | 0.0289842 | 7.52797 |
| GRD | 1.440 | 282.59 | 0.0050957 | 312.039 |
| ITL | 151.8 | 1,758.75 | 0.0863113 | 1,942.03 |
| ESP | 6.885 | 151.59 | 0.0454186 | 167.388 |
| PTE | 1.393 | 183.06 | 0.0076095 | 202.137 |
| FRF | 1.332 | 5.9881 | 0.2224412 | 6.61214 |
| GBP | 0.08784 | 1.6561 | [1] 0.1454718 | 0.666755 |
| IEP | 0.008552 | 1.4304 | [1] 0.0122328 | 0.771961 |
| | | | [2] USD/ECU 1.1042128 | |
| FIM | – | 5.4222 | – | 5.98726 |
| ATS | – | 12.59 | – | 13.9020 |
| SEK | – | 7.9082 | – | 8.73234 |

**1** The dollar exchange rate for the GBP and IEP is the number of dollars per currency unit rather than the number of currency units per dollar. Column (c) is therefore calculated for each of these two currencies by multiplying the value in column (a) by that in column (b); and column (d) by dividing the dollar equivalent of the ECU (i.e. USD/ECU) by the rate in column (b). — **2** There is a difference of one unit (i.e. 1.1042128 instead of 1.1042127) in the last significant figure because the dollar equivalents of national currency amounts are shown after rounding to the 7th decimal place, whereas an unrestricted number of digits is used for computation purposes.

In compliance with the legal framework for the use of the euro, once the irrevocable conversion rate for the euro for each participating currency has been adopted, it will be the only rate which will be used for conversion either way between the euro and the national currency unit and also for conversions between national currency units. Owing to rounding, the implicit bilateral rates which could be derived from the euro conversion rates may not always correspond, up to the last (sixth) significant figure, to the pre-announced ERM bilateral central rates referred to in this Joint Communiqué.