Briefing Paper

European Monetary Union – History and Benefits

May 2006

Introduction

In January 1993, the twelve member states of the European Community became the Single European Market. They were joined in 1995 by Austria, Finland and Sweden; and in 2004 by ten mainly Eastern European states to bring total membership to 25. The single market means the free movement of goods, services and finance, and the right to work and live in any Member State.

The European financial common market, encompassing free movement of money and capital and freedom to provide services for brokers and financial undertakings, is an essential part of that market. It has resulted in community businesses and individuals being free to invest their money, open accounts and take out loans wherever they choose. Banks and other financial institutions can now offer 'financial products' without restriction and securities are quotable on all stock exchanges and issuable in all Member States of the Community. Insurance services can also be offered without restriction.

However exchanging currencies is a costly business, both for individuals who have to pay a commission whenever they travel abroad, and for companies which are obliged to devote some of their administrative resources to currency transactions. Therefore, the Single Market could only become more effective with the introduction of a Single European Currency (The Euro).

The Euro is currently the currency of twelve of the European Union's 25 member states. It was introduced on 1st January 2002 in place of the national currencies that had previously been used. The states that use the Euro stretch from the Mediterranean Sea to the Arctic Circle and have a combined population of 346million people. They are:

- Austria
- Belgium
- Finland
- France
- Germany
- Greece
- Ireland
- Italy
- Luxembourg
- Netherlands
- Portugal
- Spain

The member states that have yet to adopt the Euro are:

- Cyprus
- Czech Republic

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- Denmark
- Estonia
- Hungary
- Latvia
- Lithuania
- Malta
- Poland
- Slovakia
- Slovenia
- Sweden
- United Kingdom

Most of these countries are relatively new accession countries to the European Union and many have plans to adopt the Euro in due course.

History of the Euro

Europe's common currency has a long history and can be traced back to the origins of the European Union itself in the 1950s.

On 19th September 1950 the European Payments Union (EPU) was established as part of the Organisation for European Economic Co-operation (the forerunner of the OECD – Organisation for Economic Co-operation and Development), providing a basis for currency convertibility in Europe. This was done through establishing an automatic mechanism for settling net surpluses and deficits of its members as part of the post-war economic recovery and integration of Europe.

The European Coal & Steel Community (ECSC) was established on 18th April 1951 by Belgium, France, Germany, Italy, Luxembourg and the Netherlands. This led to the same states forming the European Economic Community through the Treaty of Rome on 25th March 1957. The Treaty of Rome included only minor provisions for monetary co-operation between the six states. This was because all the states participated in the Bretton Woods international monetary system that had been agreed in 1944. This was based on tying all currencies to the Gold Standard through fixed exchange rates. In view of this it was not considered necessary to establish a duplicate system in the European Economic Community.

However, on 29th December 1958 the Organisation for European Economic Co-operation (OEEC) established the European Monetary Agreement (EMA) as a successor to the European Payments Union. It was designed to support general convertibility of European currencies and multi-lateral trade.

The 1960s and 1970s saw the break down of the Bretton Woods agreement with frequent devaluation and revaluation of European currencies. In the case of the United Kingdom the Pound Sterling was devalued in 1967. As a result of this instability, the European Economic Community began to consider alternative arrangements to provide currency stability in Europe through a new monetary framework. The Bretton Woods agreement finally collapsed in 1971 when the United States made a unilateral announcement that it would discontinue the convertibility of the United States Dollar to Gold. This ended the regime of fixed exchange rates completely and introduced instability to currency exchanges. In 1972 the United Kingdom government decided that it would 'float' the Pound Sterling, breaking the link between the Pound Sterling and the United States Dollar.

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As a result of this increasing instability, the Hague Summit of Heads of State and Government, held at the Hague over 1st & 2nd December 1969 had already decided to make economic and monetary union (European Monetary Union) an explicit goal of the European Economic Community and to set up a high-level group to consider how to achieve this, chaired by Pierre Werner, the then Prime Minister of Luxembourg.

Werner published his report on 8th October 1970. It proposed a three-stage plan to create an economic and monetary union within a decade. It was proposed that the principal monetary and economic decisions would be taken at Community level and certain policy responsibilities would therefore be transferred from a national to the European level. European Monetary Union was seen as a way of achieving fixed currency conversion rates, the creation of a single currency, a single monetary policy and harmonisation and ultimately unification of economic policies at the Community level. This would include control over parts of member states' national budgets and involve creating corresponding community institutions. These would include a Committee of Central Bank Governors and a body to take decisions regarding economic policy, responsible politically to the European Parliament.

The three stages that Werner proposed to establish the European Monetary Union were:

- One: Reduction of the fluctuation margins between member states' currencies, broad guidelines for economic policy at Community level, co-ordination of budgetary policy and preparation of Treaty changes to facilitate later stages of the European Monetary Union;
- Two: Integration of financial markets and banking systems to create free movement of capital, progressive elimination of exchange rate fluctuations, closer co-ordination of short-term economic policies and budgetary and fiscal measures;
- Three: Irrevocable fixing of exchange rates between participating national currencies, convergence of economic policies and establishment of a Community system of central banks.

However, the Werner proposals were not adopted. Instead, a system called the 'Snake in the Tunnel' was introduced on 24th April 1972. This was designed to narrow the margins of fluctuation between Community currencies (the 'snake') in relation to fluctuations in the United States Dollar (the 'tunnel'). On 1st January 1973, Denmark, Ireland and the United Kingdom joined the European Economic Community. However, the oil crisis of 1973 put the 'Snake in the Tunnel' under pressure and a number of member states withdrew from the system. By 1977 only five states remained in a revised system based on a currency zone surrounding the German Mark.

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The European Monetary Co-operation Fund (EMCF) was established in 1973 as the means by which co-operation was ensured between the central banks of each Member State. The Board of the European Monetary Co-operation Fund consisted of the Governors of the national Central Banks of the Member States that had contributed to the progressive establishment of Economic and Monetary Union. The Fund had the responsibility for promoting the proper functioning of the progressive narrowing of the margins of fluctuation of the Community currencies against each other, for co-ordinating interventions in Community currencies on the exchange markets, and for administering the settlement between central banks leading to a concerted policy on reserves. The European Monetary Co-operation Fund was later replaced by the European Monetary Fund.

In 1978, France and Germany proposed a new approach to monetary integration at the Brussels European Council. As a result the European Monetary System (EMS) was agreed following the European Councils in Copenhagen and Bremen in December 1978. This had the objectives of stabilising exchange rates, reducing inflation and preparing for monetary integration. The system came into force on 13th March 1979.

The objective of the European Monetary System was to establish a closer degree of monetary co-operation between Member States which would in turn lead to a "zone of monetary stability in Europe". The European Monetary System formed part of an overall strategy that was aimed at achieving 'lasting growth with stability, a progressive return to full employment, the harmonisation of living standards and the lessening of regional disparities'.

The European Monetary System had three elements:

- The 'Currency Basket' (European Currency Unit (ECU))
- Monetary Stabilisation Mechanism (Exchange Rate Mechanism (ERM))
- Mechanism for financing monetary interventions (European Monetary Co-operation Fund (FECOM))

The idea was for each national currency to have a central exchange rate against the European Currency Unit that also gave them central cross rates against each of the other currencies. National states were then required to maintain their exchange rates within a 2.25% fluctuation band above or below each bilateral central rate. The only exceptions to this were Italy that had a margin of 6%, and the United Kingdom that was the only member state unable to enter into the system.

Greece joined the European Economic Community on 1st January 1981, while Portugal and Spain joined on 1st January 1986.

In February 1986, the twelve member states of the European Economic Community signed the 'Single European Act' that aimed to create:

"An area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty."

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This necessitated an ambitious programme of legislation to eliminate the ongoing barriers to internal trade between member states. It also required the end of the fragmentation of the Community market that was considered to be a barrier to Europe's competitiveness at a global level. Monetary co-operation was included as a new area of Community competence.

In June 1988, the European Council met in Hanover and established a Committee, chaired by Mr Jacques Delors and that included all the European Community Central Bank governors to study and propose concrete steps towards economic and monetary union. The Council stated that:

"In adopting the Single Act, the Member States of the Community confirmed the objective of progressive realisation of economic and monetary union."

The committee had:

"The task of studying and proposing concrete steps leading towards (monetary) union."

The Delors Committee reported in April 1989 and set out a plan to introduce European Monetary Union in three stages, including an institutional framework to allow policy to be decided and implemented at the Community level in areas of economics that are considered to be directly relevant to European Monetary Union.

Delors proposed creating a monetary institution, a European System of Central Banks (ESCB) that would become responsible for forming and implementing monetary policy and managing external exchange rate policy.

However, Delors did not propose a new body to co-ordinate economic policy favouring a system of carrying out these functions within the existing institutional framework.

The three stages proposed for developing European Monetary Union were:
- First: Increased co-operation between central banks with relation to monetary policy, removal of obstacles to financial integration, monitoring of national economic policies and co-ordination of budgetary policy;
- Second: The preparatory stage for the final phase of European Monetary Union, establishment of the European System of Central Banks and progressive transfer of monetary policy to European institutions and narrowing of margins of fluctuation within the exchange rate mechanism;
- Third: Fixing of exchange rates between national currencies and their replacement with a single European currency with responsibility for monetary policy being transferred to the European System of Central Banks

By this time it was widely agreed by economists and politicians that the European Monetary System had been a success. It was thought that the next step should be to establish a single European currency and its environment of stability was expected to provide the citizens of Europe with many practical advantages including:
- A more efficient single market, once the single currency was in place
- The stimulation of growth and employment
- Elimination of the additional costs connected with the existence of several European currencies

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- An increase in international stability
- Enhanced joint monetary sovereignty for the Member States.

The Delors report was adopted by the Madrid European Council in June 1989 and it was agreed to launch the first stage of European Monetary Union on 1st July 1990. This was followed by the Strasbourg European Council in December 1989 that agreed to convene an Intergovernmental Conference (IGC) to prepare changes to the Treaty of Rome that would facilitate the introduction of European Monetary Union.

Stage one of the Delors plan started on 1st July 1990 and covered the following points:

- All Member States must participate in the Exchange Rate Mechanism on equal terms, as full members of the European Monetary System.
- The freedom of movement of capital must be achieved between all Member States.
- Agreement must be reached on a way of establishing a system under which the central banks should decide on monetary policy, foreign market intervention and banking supervision.
- There must be complete freedom to provide financial services (i.e. banking, financial and insurance services) throughout the Community.

This led, in February 1992, to the signing of the Treaty of Maastricht that established European Monetary Union as a formal objective of the European Union. The treaty includes some economic convergence criteria for member states to participate in the European Monetary Union concerning the inflation rate, public finances (relating to budget deficits and public sector debt), exchange rate stability and long-term rates of interest. The Treaty of Maastricht came into force in November 1993.

The Maastricht Treaty also enshrined the principles of monetary union and laid down more detailed criteria by which it would be achieved. The treaty:

- Was designed to establish the single currency as one of the most stable currencies in the world
- Established the need for economic and monetary decision making centres which would be strong and balanced
- Set a single currency goal to match those with the best track records
- Laid down a precise and realistic timetable for achieving this goal.

The Treaty also established the entry criteria on which to judge which member states would be allowed to participate in stage three. The Convergence Criteria that were agreed as part of the Maastricht Treaty of 2002 were:

- Exchange Rate Stability: A country's currency must have remained within the normal fluctuation bands of the Exchange Rate Mechanism for at least two years, without devaluing on its own initiative against any other member currency.
- Price Stability: A rate of inflation no more than 1.5% above the average of the rates of the three countries with the lowest inflation rates during the previous year.
- Budget Deficit: The Annual General Government Deficit should be 3% or less of the GDP (Gross Domestic Product), or at a level close to 3% and to be declining significantly.
- Government Debt: The general government debt ratio should not exceed 60% of GDP, or at a level close to 60% and to be diminishing significantly.

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- Long Term Investment Rates (Bond Yields): The average long term interest rates must not have been more than 2% above the average of the rates in the three counties with the lowest inflation rate.

The Exchange Rate Mechanism was used to link the exchange rates of all the participating Member States' currencies to each other and to the European Currency Unit (ECU). Each country that participated in the Exchange Rate Mechanism could not allow the exchange rate of their currency against the other currencies to fluctuate by more than a given percentage above or below the so-called central rate (known as the band).

The European Currency Unit consisted of specific and fixed amounts of Member States currencies. It was a composite sometimes called a basket of currencies. The amount of each currency reflected the country's share of collective Gross National Product and its share of collective trade. The different amounts of national currency within the European Currency Unit basket were used to calculate the relative values of each national currency on a daily basis. The following table shows the composition of the European Currency Unit Basket and the Percentage Share of Each Currency, as it was agreed in 1993.

National Currency	Composition of the ECU Basket (frozen on 1.11.93)	Percentage share of each currency in the ECU basket (as at 28.1.93)
		%
German Mark	0.6242	32.63
French Franc	1.332	19.89
Dutch Guilder	0.2198	10.23
Belgian and Luxembourg Franc	3.431	8.28
Italian Lira	151.8	8.16
Spanish Peseta	6.885	4.50
Danish Krone	0.1976	2.56
Irish Punt	0.008552	1.06
Portuguese Escudo	1.393	0.71
Non-ERM Members		
Greek Drachma	1.44	0.53
UK Pound	0.08784	11.45
		100.0

If currencies reached the limits of their band the Member States' central banks had to intervene to support each other's currencies, for example by buying it if it was falling through the bottom of the band. The intervention was intended to provide stability and to counter currency speculation where capital flights occurred, with adverse results. The flexibility of the Exchange Rate Mechanism was preserved by the ultimate possibility of a realignment of national exchange rates.

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When a new Member State joined the European Monetary System, and participated in the Exchange Rate Mechanism, the status of their currency would have been identical to that of the other participating currencies, but without forming part of the European Currency Unit basket. These currencies would therefore have had a central rate against the European Currency Unit and a bilateral central rate against each of the other currencies that had participated in the Exchange Rate Mechanism.

The United Kingdom joined the Exchange Rate Mechanism on 5th April 1992.

The new Exchange Rate Mechanism faced its first major test in September 1992 on 'Black Wednesday' when turbulence on the foreign exchange markets destabilised some of the weaker currencies in the system. The British Pound Sterling and the Italian Lira both moved through the 'floor' value for fluctuations were devalued. The United Kingdom suspended it's participation in the Exchange Rate Mechanism on 16th September 1992 and has not rejoined since.

Further speculative pressure – especially on the French Franc and Spanish Peseta - led in August 1993 to a widening of the Exchange Rate Mechanism fluctuation bands so that currencies could move up to 15% above or below the central bilateral rates.

The composition of the European Currency Unit basket was frozen on 1st November 1993 when the Treaty on European Union came into effect. The monetary amounts of each currency making up the European Currency Unit were then irrevocably fixed until the beginning of Stage three of Economic and Monetary Union by which time the European Union would have a currency in its own right.

From then, until the Euro was launched on 1st January 1999, the exchange rate of each currency against the other Member States' currencies and against the European Currency Unit still varied on a daily basis. These minor variations did not have any effect on the fixed composition of the European Currency Unit. Only if a member state had left the Exchange Rate Mechanism or had been subjected to severe market pressures would there have been any realignment.

If a currency had crossed its 'threshold of divergence' against another member's currency it was expected that both countries would have taken action to restore parity. If market pressures had become too severe then adjustments would have been implemented by realignment that is by mutually agreed devaluations or revaluations of the central rates.

Stage two of the Delors plan began on 1st January 1994. The European Monetary Institute (EMI) was established in Frankfurt to help to develop the conditions necessary for the transition to stage three which were to:

- Strengthen the co-ordination of monetary policies with a view to ensuring that the Member States agreed on and could meet the convergence requirements that were required for entry into a single currency. These were included in the Maastricht Treaty of 1992.
- Make preparations for the European System of Central Banks (ESCB) and for the conduct of a single monetary policy and the creation of a single currency in the third stage.
- Oversee the development of the European Currency Unit.

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The European Monetary Institute (EMI) was established in January 1994. It was planned that it would act as the forerunner to a European Central Bank. It had already been established that it would be based in Frankfurt. The objective of the European Monetary Institute was to help to establish:

"The conditions necessary for the transition to the third stage of economic and monetary union… by strengthening the co-ordination of monetary policies with a view to ensuring price stability; making the preparations required for the establishment of the European System of Central Banks, and for the conduct of a single monetary policy and the creation of a single currency in the third stage." (Article 2 of the Protocol on the EMI)

This included strengthening co-operation between the national central banks, strengthening the co-ordination of national monetary policies with the aim of ensuring price stability; and supervising the technical preparation of European Currency Unit banknotes.

The European Monetary Institute was charged under the Maastricht Treaty with preparing by the end of 1996 the regulatory, organisational and logistical framework for the European System of Central Banks (ESCB) to function as a central bank. This 'blueprint' was published in January 1997 and contained the European Monetary Institute's recommendations for the broad framework for operating monetary policy in Stage three.

One of the main tasks of the European Monetary Institute was therefore to prepare the ground for the European System of Central Banks to be in a position to conduct its business as from the start of Stage Three. Directly pursuant to its Treaty mandate, the European Monetary Institute undertook in particular to:

- Prepare a range of instruments and procedures for the conduct of the single monetary policy in the future Euro area and analyse potential monetary policy strategies
- Promote the harmonisation of the collection, compilation and distribution of properly articulated Euro area statistics with respect to money and banking, balance of payments and other financial data.
- Develop the framework for conducting foreign exchange operations as well as for holding and managing the official foreign exchange reserves of the Member States participating in the Euro area
- Promote the efficiency of cross-border payment and securities settlement transactions in order to support the integration of the Euro money market, notably by developing the technical infrastructure (the TARGET system) for the processing of cross-border payments in Euro to be as smooth as that of domestic payments
- Prepare the Euro banknotes, including their design and technical specifications.
- Put in place the necessary information and communication systems support for the operational and policy functions to be undertaken within the European System of Central Banks
- Identify the possible ways in which the European System of Central Banks would contribute to the policies conducted by the competent supervisory authorities to foster the stability of credit institutions and the financial system.

Furthermore, the European Monetary Institute co-operated with other European Union bodies in preparing for Stage Three. In particular, either pursuant to a treaty requirement or in response to an invitation from the European Council, it submitted reports on:

- A scenario for the changeover to the single currency
- Monetary and exchange rate policy co-operation between the Euro area and other European Union countries
- The progress made in the fulfilment by the European Union Member States of their obligations regarding the achievement of the conditions necessary for participation in Economic and Monetary Union (economic and legal convergence).

The European System of Central Banks comprises the European Central Bank and the national central banks of all European Union Member States. The "Eurosystem" was the term used to refer to the European Central Bank and the National Central Banks of Member States that have adopted the Euro. The National Central Banks of the Member States that are not participating in the Euro are members of the European System of Central Banks with special status. This allows them to conduct their own national monetary policies but they do not take part in the decision making processes controlling the Euro.

The primary objective of the Eurosystem is to maintain price stability and its main tasks are to:

- Define and implement the monetary policy of the Euro area
- Conduct foreign exchange operations
- Hold and manage the official foreign reserves of the Member States
- Promote the smooth operation of the payments system

The process of decision making in the Eurosystem is centralised through the decision making bodies of the European Central Bank, namely the Governing Council and the Executive Board. As long as there are Member States that have not yet adopted the Euro, a third decision making body, the General Council also exists.

Austria, Finland and Sweden joined the European Union in January 1995.

The European Council met in Madrid in December 1995 and decided to introduce the European currency on 1st January 1999 and that it would be called the 'Euro'. The key elements that they agreed for the changeover were:

- A decision on which member states would participate in the Euro would be made as early as possible during 1998, based on economic data from 1997;
- The early creation of the European Central Bank and appointment of its Executive Board
- There would be a three year transition between the introduction of the Euro and the introduction of notes and coins
- The principle of 'no compulsion, no prohibition' that meant that transactions could be carried out in Euros or in national currencies during the transitional period.
- A maximum six month period for the dual circulation of national currencies and the Euro (later reduced to two months)

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The transition to the single currency would take place in three main phases, for which definite dates were fixed:

- In May 1998 the European Council in conjunction with the Heads of State and Government would announce which countries were eligible to join the first group to establish European Monetary Union.
- On 1st January 1999 the European Monetary Union would effectively start among the first wave of countries concerned, with the rates of conversion between the Euro and the participating currencies being irrevocably fixed.
- By 1st January 2002 the introduction of the new banknotes and coins would commence the final changeover to the Euro as the single currency of the Member States taking part in European Monetary Union.

The Madrid Summit agreed that, by not later than 1st January 2002, and over a short period of not more than six months, the new Euro banknotes and coins would be put into circulation and the old national currencies withdrawn. This phase should last no longer than would be strictly necessary in order to minimise the complications for users that could be caused by national currencies remaining in circulation for an extended period alongside the single currency. The process of physically exchanging national currency for Euro would have to be thoroughly prepared. In some cases (reprogramming of tills, cash dispensers and payment terminals, for example) preparations would need to begin a long time beforehand, with the technical specifications for coins and banknotes being widely disseminated to ensure that software and machinery are properly adapted. The operation would end by 1st July 2002, when Euro banknotes and coins would alone have legal tender status.

Under the Treaty of the European Union, the European Monetary Institute had the responsibility for supervising the technical preparation of the Euro banknotes. In Stage 3 the Governing Council of the European Central Bank had the responsibility to authorise the issue of banknotes within the European Union and the national central banks distributed them through their banking systems.

Responsibility for harmonising Euro coins lay with the Council of the European Union, which is with the Ministers of the Member States, acting by a qualified majority on a proposal from the Commission. However, the European Central Bank also had to be consulted. The national central banks looked after the distribution of coins throughout their territory, including making coins available to banks and the public. Specific national characteristics were taken into account, as traditions and habits are of fundamental importance. These included the language used for inscriptions and the depiction of sovereigns or national symbols on the two sides.

The European Council held in Amsterdam in June 1997 agreed the ‘Stability and Growth Pact’ that is designed to ensure budgetary discipline in the member states that were to join the Euro. The Council also agreed a new Exchange Rate Mechanism (ERM II) to provide stability between the Euro and the currencies of those nations that would not join the Euro.

In those countries within the European Union, but not within the European Monetary Union (Denmark, Sweden and the United Kingdom), the Euro is treated as a foreign currency and the relationship between their national currency and the Euro is controlled by ERM II.

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In May 1998 the Heads of State and Government met in Brussels and agreed that eleven member states fulfilled the convergence criteria and would be eligible to take part in the launch of the Euro from January 1999. This was confirmed by the European Council. This was done on the basis of convergence reports prepared by the European Commission and the European Central Bank that identified which member states had fulfilled the criteria contained in the Maastricht Treaty.

The Maastricht Treaty made provision for the establishment of an Independent European Central Bank, which was to replace the European Monetary Institute and similarly be based in Frankfurt. In June 1998 the European Central Bank was actually created when the member states that were to adopt the Euro appointed their representatives to the Executive Board. This replaced the European Monetary Institute. The Bank continued the work of preparing for the introduction of the Euro.

The European Central Bank comprises several decision making bodies.

The Governing Council comprises the members of the Executive Board and the governors of the National Central Banks of the Member States that have adopted the Euro. The main responsibilities of the Governing Council are to:

- Adopt the guidelines and take the decisions necessary to ensure the performance of the tasks entrusted to the Eurosystem.
- Formulate the monetary policy of the Euro area, including decisions relating to intermediate monetary objectives, key interest rates and the supply of reserves in the Eurosystem
- Establish the necessary guidelines for their implementation.

The Executive Board comprises the President, Vice- President and four other members, all chosen from among persons of recognised standing and professional experience in monetary or banking matters. They are appointed by common accord of the governments of the Member States at the level of the Heads of State or Government, on a recommendation from the European Union Council after it has consulted the European Parliament and the Governing Council of the European Central Bank. The main responsibilities of the Executive Board are to:

- Implement monetary policy in accordance with the guidelines and decisions laid down by the governing Council of the European Central Bank and in doing so; give the necessary instructions to the National Central Banks.
- Execute those powers which have been delegated to it by the Governing Council of the European Central Bank.

The General Council comprises the President and the Vice-President and the governors of the National Central Banks of all member States. The General Council contributes to the:

- European Central Bank's advisory functions
- Collection of statistical information
- Preparation of the European Central Bank's annual reports
- Establishment of the necessary rules for standardising the accounting and reporting of operations undertaken by the National Central Banks
- Preparations for irrevocably fixing the exchange rates of the currencies of the Member States not yet in the Euro.

One of the priorities of the European Central Bank Governing Council when it took over from the European Monetary Institute was to finalise the outstanding issues relating to its monetary policy strategy.

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On 31st December 1998 the conversion rates between the national currencies and the Euro were fixed permanently and became the official rates for conversion of the national currencies into the Euro.

The final stage of the Delors plan that began on 1st January 1999 saw:

- The exchange rates of the 11 participating Member States' currencies becoming fixed irrevocably. Greece was to join at a later stage.
- The start of the transition process for those 11 countries that has eventually seen the single currency replace their own national currencies.
- A new European Central Bank (ECB) that has assumed responsibility for a single European monetary policy from the European Monetary Institute.

The eleven European Union countries that established the Euro as their new currency on 1st January 1999 were: Austria, Belgium, France, Finland, Germany, Ireland, Italy, Luxembourg, The Netherlands, Portugal and Spain. The European Central Bank also established a single monetary policy. European Monetary Union had been established.

While the national currencies continued to be used for three years, they were legally regarded as non-decimal sub-divisions of the Euro. The 'no compulsion, no prohibition' principle applied during which people could use either the Euro or the national currencies.

Government debt in the Euro area was issued in Euros from that date. Financial markets in the Euro area also switched to the Euro – including share, bond and foreign exchange markets.

The Member States of the Euro zone had already adapted their legislation in preparation for the arrival of the Euro. This enabled their financial markets to make the changeover on 1st January 1999 and for firms to use the Euro in their financial statements and tax returns and in denominating their capital in Euros.

Member States then started drawing up their scenarios for the introduction of Euro notes and coins on the 1st January 2002. This whole process came to an end with a two-fold challenge of putting Euro notes and coins into circulation, whilst withdrawing the notes and coins of the old national currencies.

With the start of European Monetary Union on 1st January 1999, there was a need to convert monetary amounts between the Euro and its 11 national denominations on a regular basis. The way in which these conversions were carried out was governed by the provisions in the Article 235 Regulation (Council Regulation (EC) 1103/97). The rules for conversion, rounding and 'triangulation' contained in the Regulation, with examples can be found in Appendix B.

The Dual display of prices (the Euro and the national currency) was left to traders to organise. Only in Austria was it decided to make dual pricing mandatory as from 1st October 2001.

In the Business sector it was the large and multi-national companies that were more advanced in their preparations, with their higher volume of cross border trading. The Small and Medium Enterprises (SMEs) were much slower to respond with many taking the decision to wait until the currency changeover in January 2002.

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For Public Administrations, most Member States had authorised the optional use of the Euro from January 1999, in their financial statements. Most Public Authorities chose to wait to the end of the transition period before switching their accounts to the Euro. Local authorities had a key role to play. They had to prepare themselves for the changeover and were also particularly well placed to raise public awareness and conduct general information campaigns, especially for vulnerable social groups.

The co-existence after 1st January 1999 of Member States inside and outside the Euro area raised a host of issues. These included the functioning of the single market, the institutional consequences in the European Union Council, the consequences for the European Union Budget and exchange rate relations between the 'ins' and the 'outs'. The Exchange Rate Mechanism II was introduced to govern these issues.

The European Monetary Institute designed a "hub and spokes" structure (that is, with the currencies of participants pegged to the Euro rather than in a parity grid arrangement as in the original Exchange Rate Mechanism). This reflected the central role that the Euro inevitably played now that European Monetary Union had started. The European Monetary Institute suggested in addition that it should be possible for individual 'out' Member States to limit bilateral fluctuations between their currencies by mutual bilateral agreement. Wide fluctuation bands around the Euro were envisaged, but with the possibility for countries to adopt narrower bands on an ad hoc basis, within some kind of standardised framework.

The European Monetary Institute proposed that there would, in principle, be automatic intervention at the margins, but with an escape clause, designed particularly to protect the Euro area's monetary policy and so allow the European Central Bank to suspend intervention if its primary goal of price stability was being threatened. The European Central Bank has the right, as well as the other parties involved, to initiate realignment discussions if it appeared that the central rate of a currency was out of line with fundamentals.

The Federation des Comptables Européens (FEE) is the representative organisation for the accountancy profession in Europe, currently grouping together the 38 leading institutes in 26 countries,

The Federation des Comptables Europeens was granted a contract to assist the Commission in its work on the practical implementation of a single currency, up to its launch on the 1st January 2002. The accountancy profession was seen by the Commission as a key conduit of information and practical advice to organisations and the Chartered Institute of Public Finance and Accountancy, in particular was seen as an important link to local government and other public sector organisations.

In June 2000 Heads of State and Government met at the Feira European Council and agreed that Greece had met the conditions for entry to the Euro by fulfilling the convergence criteria and would join the Euro as the twelfth state in January 2001.

Euro notes and coins were distributed prior to general circulation in September 2001. Each member state had its own national changeover plan that determined how the new notes and coins were to be distributed to commercial banks, post offices and retailers. Over 150million Euro coin starter kits were distributed in December 2001.

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A Television and press advertising campaign run by the European Central Bank and the National Central Banks of the countries in the Euro-zone was launched on September 2001. This was aimed at familiarising Euro citizens with the new currency and its security features. In October 2001 an information leaflet entitled "Getting ready for the Euro – Your guide to the Euro banknotes and coins" was distributed to all households.

The frontloading of Euro cash to banks across the Euro-zone started in September 2001 and "Starter Kits" of Euro coins were made available for purchase from banks and post offices in December 2001.

Euro notes and coins entered general circulation on 1st January 2002 while national notes and coins began to be withdrawn. E144billion was put into circulation through 7.8billion Euro notes and 40.4billion Euro coins. Banks in the Euro area began to issue cash in Euros, while shops gave change in Euros. There was a transition period during which the Euro and national currencies were both in circulation, and people were able to spend their national currencies in shops or change it to Euros in the banks. Banks in countries outside the Euro area also began to issue Euros to people who planned to travel to the Euro area. National currencies were finally withdrawn on 28th February 2002.

Denmark and Sweden both met the criteria for joining the Euro and held referenda. In September 2000 Denmark voted not to join the Euro, although the Danish Krona continues to 'shadow' the Euro under the provisions of the Exchange Rate Mechanism II. Sweden held its referendum on the Euro in September 2003 and also voted against joining the Euro.

May 2004 saw the expansion of the European Union with the accession of ten new member states, mainly in Eastern Europe. They do not have a fixed timetable to join the Euro, although most of them have expressed a wish to do so, and should be able to once they have met the convergence criteria that were established as part of the Maastricht Treaty.

Benefits of the Euro

Economic and monetary union in Europe implies the free movement of persons, goods, services and capital within the Community, a common monetary policy and irreversibly fixed exchange rates between the national currencies of the Member States.

The European Union considers that there are a number of benefits to having a single European currency that have been the major motivations behind the creation of the Euro. These are:

- Practical benefits for citizens who travel with the Euro.
- Enabling businesses and citizens to reap the full benefits of the European Union's Single Market
- Benefits for savers and borrowers from a single financial market
- Benefits to the economy as a whole of a single currency creating a single macroeconomic framework
- Advantages for Europe's international role
- Benefits related to the wider process of political integration

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With the introduction of the Euro, citizens can travel more easily within the Euro area without the hassle of changing currencies each time they cross a border. Citizens are better able to compare prices as they can use their own currency anywhere in the Euro area. As the Euro is an international currency, it is widely accepted in many places outside the Euro area, especially tourist destinations, so it becomes easier for citizens to travel outside the Euro area. In particular:

- A single currency eliminates all transaction costs. It saves a substantial amount of money as the costs associated with converting one currency into another are eliminated - exchange margins and commission fees paid to banks disappear.
- In the past a traveller touring all European Union countries and exchanging his cash in each Member State for the local currency lost 49.5% of his budget to exchange costs and bank commission charges
- There is no need to carry several different currencies for use when travelling to other European Union countries. Euro bank cards and travellers' cheques avoid the inconvenience of carrying numerous currencies and are accepted at all European Union banks and many other establishments

The European Union considers that a single currency is the natural complement to the European Union's single market, allowing it to function more efficiently and making it more conducive to economic growth. This results from the following:

- Elimination of exchange rate fluctuations – providing a more stable environment for trade within the Euro area by reducing risks and uncertainties for both exporters and importers that previously had to factor exchange rate risks into their costs. Independent research has shown that the Euro has fostered a significant growth in trade within the Euro area.
- Businesses are better able to plan their investment decisions because of reduced uncertainties.
- Various transaction costs related to the management or exchange of different currencies are eliminated. This includes the costs of:
    - Foreign exchange operations (buying and selling foreign currencies)
    - Hedging operations (intended to protect companies from adverse movements in exchange rates)
    - Cross-border payments (cross border payments in foreign currency are usually slower and more costly than domestic payments)
    - Management of several currency accounts (causing complicated currency management and internal accounting systems)
    - It is a more efficient system to transfer money to another country. It is calculated that in the past a bank transfer of an amount equivalent to 100 Euros from one Member State to another would have cost, on average, 24% of the total amount and could have taken five working days. These types of cost are now saved and this is particularly valuable to small and medium sized enterprises
- Price transparency – as prices of goods and services are expressed in the same currency, businesses and consumers can compare prices more easily.
- Enhanced competition – The European Union believes that easier price comparisons foster competition and therefore cause lower prices in the short to medium term. Consumers, wholesalers and traders will buy from the cheapest source; businesses can no longer charge the highest price that each national market would bear; and so a general downward pressure on prices results.
- More opportunities for consumers – A single currency facilitates travelling and buying goods and services in different countries, especially when combined with the progress of e-commerce.

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- More attractive opportunities for foreign investors – The European Union believes that a large single market with a single currency means that investors can do business throughout the Euro area with minimal disruption and can also take advantage of a more stable economic environment.
- There are other advantages for Europe's business sector, i.e. simplified accounting for all kinds of businesses reduces red-tape. Small and medium sized enterprises throughout the European Union now benefit from the reduction in transaction costs. The elimination of exchange rate fluctuations reduces the exchange rate risk for companies trading or investing across the European Union, therefore stimulating trade investment and economic growth.

The Euro is considered to bring benefits to the economy as a whole through its impact on the macroeconomic framework. The European Union considers that Economic & Monetary Union is based on the establishment of a sound and healthy macroeconomic framework that is characterised by:

- Price Stability – This is the primary objective of the European System of Central Banks that operates independently of the European Union.
- Sound public finances – The Maastricht Treaty contains provisions to ensure that members states avoid excessive levels of government deficits or excessive levels of public debt in relation to Gross Domestic Product. The Stability and Growth Pact also provides that member states should have budgets that are close to balancing or in surplus over the medium term.
- Low Interest rates – The European Union considers that the level of interest rates benefits from low inflation expectations, improved control of government debt (that allows for improved borrowing possibilities for private companies) and the increased size of the Euro securities markets that improves liquidity. They also consider that the elimination of exchange rate fluctuations has a beneficial impact on intra-European trade and a further downward impact on interest rates.
- Incentives for growth, investment and employment – The European Union considers that price stability, sound public finances and low interest rates constitute ideal conditions to foster economic growth, investment and employment creation within the European Union.
- Shelter for external shocks – The economy of the Euro area is large and most of its trade takes place within the area (between 50% and 75% depending on the member state concerned). Therefore, the Euro area is considered to be far better equipped than the previous national currencies to withstand external 'economic shocks' or fluctuations in the external exchange rate against the United States Dollar or other major currencies. The Euro is also becoming a major transaction currency enabling a significant proportion of European exports and imports to be invoiced in Euros.

The single financial market is considered to bring benefits for savers and borrowers. The European Union considers that a single currency zone opens up huge opportunities for both capital suppliers (savers and investors) and capital users (private or corporate borrowers and issuers of equity capital). This is because:

- The Euro helps to provide a single market for financial operators (including banks, insurers, investment funds and pension funds).
- Small and fragmented national capital markets evolve into a larger, deeper and more liquid financial market.

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It is considered that this is beneficial to both savers and borrowers as:

- Savers can benefit from a wider and more diversified offer of investment and saving opportunities. Investors can spread their risks more easily and have an appetite for riskier ventures.
- Private and corporate borrowers as well as equity issuers benefit from better funding opportunities because money is easier to raise on capital markets.

The European Union considers that the Euro provides advantages to Europe in its international role. This is because:

- A single currency gives maximum credibility towards other international currencies. A strong international currency will withstand, more confidently, the pressures which are put on separate currencies, thus discouraging uncertainty about interest rates
- Europe's role in international fora and organisations is strengthened by having a single currency and an economic and monetary union. This applies to the International Monetary Fund, World Bank and Organisation for Economic Co-operation and Development.
- The Euro is an international currency and is taking on an important role as an international investment and reserve currency. The Euro has already become a major currency in which to borrow money. Issues of international securities denominated in Euros are now of a similar scale to those denominated in United States Dollars.
- Europe has always played a significant part in world trade and this is leading to the Euro's use in international trade expanding. The European Union considers that a single currency makes Europe a strong partner to trade with and facilitates access to a genuine single market for foreign companies that will benefit from the lower costs of doing business in Europe.
- It is considered that the option of using the Euro to price international goods and commodities, including oil and metals, will become more attractive over time.

The European Union sees the introduction of the Euro as part of a wider process of gaining benefits from the political integration of Europe. In particular:

- The Euro can be seen as a symbol of a common European identity, shared values and the success of European integration in bringing the peoples and nations of Europe together.
- The Euro acts as a stimulus to further integration by showing that common action by member states can bring widespread benefits to all those who take part.

However, the introduction of the Euro has not been welcomed by everybody in all the member states. In particular, it is suggested in all member states that, in practice, the introduction of the Euro has led to increases in prices. This is the opposite of what the European Union had anticipated.

Analysis by Eurostat, the European Union's statistical service, indicates that the Euro changeover led to some price increases in specific sectors such as restaurants, cafes and hairdressers but that overall the effect on prices in the Euro area was limited. For the all items harmonised index of consumer prices, the price increase was calculated as being between 0.1% and 0.3%.

However, even this small increase was contrary to the expectations of the European Union that is still predicting that the introduction of the Euro will reduce prices in the medium term.

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Conclusions

The Euro is now the established currency for 346million people living in twelve of the member states of the European Union and a major international trading currency.

Since 1957, the original six signatories of the Treaty of Rome have been building a Single European Market that has been joined by nineteen other European countries since. Currency instability was always seen as a barrier to the creation of the Single European Market and so, since the collapse of the Bretton Woods agreement, the European Union has concerned itself with monetary policy. Firstly, greater stability in the exchange rates between European currencies was sought. Secondly, it was decided to replace all the national currencies with the Euro. Twelve member states have adopted the Euro and most of the remainder have plans to do so.

The European Union considers that there are a number of benefits to having a single European currency that have been the major motivations behind the creation of the Euro. These are:

- Practical benefits for citizens who travel with the Euro.
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- Benefits related to the wider process of political integration

The United Kingdom government is in favour of the United Kingdom joining the Euro in principle. However, in practice it has established five economic tests that it wishes to see fulfilled before the entry of the United Kingdom. Furthermore, it has decided that government, parliament and the electorate (in a referendum) must all agree before the United Kingdom adopts the Euro. In the meantime it is urging all public, private and voluntary organisations to prepare for the introduction of the Euro at a future date.

Preparations should cover strategic issues, awareness of the European Monetary Union and systems software. A national changeover plan has been prepared and guidance issued to local authorities and others on the preparations necessary for the introduction of the Euro.

The Chartered Institute of Public Finance and Accountancy has established a Euro Panel and Euro Forum and has issued advice and guidance to public sector bodies on how to address the challenges and opportunities presented by European Monetary Union.

Adrian Waite
May 2006