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A QUANTUM LEAP TOWARD EMU

Significantly advancing the Community toward a European central bank and a single currency, 11 of the 12 EC heads of government agreed to a timetable (and to preconditions) for stage two of economic and monetary union (EMU) at a special European Council in Rome on October 27-28.

This breakthrough, which was not expected before the mid-December inter-governmental conference (IGC) on EMU, will set the tone for the negotiations on a new treaty for a "Eurofed" and, eventually, a single currency.

Eleven heads of state (only the UK dissented) agreed that the Eurofed would begin its operations on January 1, 1994 — the official starting date for stage two — if certain conditions are met. First, the single market program must be finished; second, the greatest possible number of EC currencies should be in the exchange rate mechanism (the UK joined last month and only Greece and Portugal are yet to enter); and third, the EMU treaty that comes out of the IGC must be ratified by the member states' parliaments.

It was also decided that the forthcoming treaty would ensure the independence of the new monetary institution from national political influences, and that the monetary financing of budget deficits and the rescue of insolvent member states would be prohibited. Further, the Council noted that in order to move on to the second stage, further satisfactory progress towards "real and monetary convergence will have to be achieved", especially in terms of price stability and sound fiscal policies.

The goals of stage two are to strengthen the coordination of monetary policies; to develop the instruments and procedures needed for the future conduct of a single monetary policy; and to oversee the development of the ecu. Within three years from the start of stage two (at the latest), the Commission and the Eurofed will report to the Ecofin and General Affairs Councils on the functioning of stage two in order to make a decision on the timing of stage three, which would see the introduction of the ecu as the single European currency.

ONE MONEY, ONE MARKET

Economics Affairs Commissioner Henning Christophersen recently presented a new Commission study — "One Market, One Money" — which provides (à la the Cecchini Report) a comprehensive analysis of the potential benefits and costs of economic and monetary union (EMU). Authored by the Commission and outside experts, the report identifies five broad areas of impact that a single currency would have on the Community.

First, EMU would promote **greater efficiency and growth.** A single currency would eliminate currency transaction costs, yielding savings from 13 to 19 billion ecu (ecu1=$1.36). For the EC in aggregate, this represents a gain of around 0.5% of GDP annually. (The smaller, open economies would gain as much as 0.9% of GDP.) In addition, EMU would eradicate exchange rate uncertainty within the EC. In recent years this variability has averaged 0.7% per month for ERM (the EMS exchange rate mechanism) currencies and 1.9% for non-ERM currencies (i.e. each currency against all other EC currencies). Coupled with the completion of the single market, the elimination of exchange rate variability and transaction costs would lead not only to "static efficiency" gains, but also to a higher rate of sustainable growth.

Another EMU benefit would be **price stability.** An independent "Eurofed" following a low-inflation policy would create conditions for greater economic growth in the Community. A very low common rate of inflation could be achieved at a minimum transitional cost through a clear political commitment to a Eurofed of this design. Rejecting the argument that a rigorous anti-inflation policy would increase unemployment, the report projects that a 1% decrease in price fluctuations within the EC could increase real EC output by 0.3%.

Third, the role of the **national budgetary**

policies would be substantially revised, with new needs for fiscal autonomy to permit flexibility combined with enhanced discipline over excessive deficits to ensure an appropriate EC policy mix. One cost of EMU would be the loss of "seigniorage", whereby the national central banks make profits from the issue of their own bank notes. This could cost high inflation countries like Greece and Portugal as much as 1% of GDP over five years. Still, the study maintains that this would be more than offset by lower interest payments due to reduced interest rates.

The main cost of EMU would be the **loss of the national monetary and exchange rate instrument,** but this should not be exaggerated. Already within the ERM this instrument has been largely renounced, while adjustments vis-a-vis the rest of the world would remain possible. Changes in real exchange rates (competitiveness) would be possible (and desirable) within an EMU as long as wage and price flexibility exist. Further, there is no reason to believe that EMU would be harmful to the EC's less developed regions: EMU would enable these regions to attract more long-term investments from a well organized capital market.

Last, the EC's single currency, the ecu, would develop into a **major international currency,** resulting in lower transaction costs in international trade (0.05% of Community GDP), more ecu-denominated financial issues managed by European banks, a diminished need for foreign currency reserves and seigniorage gains on foreign holdings of ecu notes. EMU would facilitate international monetary coordination by establishing a balanced tri-polar regime of ecu, dollar and yen.

COMMISSION CLEARS AIR FRANCE MERGER

The Commission recently approved the merger of Air France with two other French airlines — UTA and Air Inter — after the French government agreed to open its domestic air market to competition.

EC Competition Commissioner Sir Leon Brittan described the decision as a "breakthrough in competition policy" that will bring "great practical advantages to the travelling public in France and elsewhere in the Community."

Although the merger creates one of the world's largest airline groupings, the "new" Air France must gradually relinquish its monopoly over 50 international routes by the start of 1992, including the immediate opening of 10 routes where Air France and UTA were competing before the merger. Eight domestic routes, which account for over half of France's internal air traffic, will also be opened to competition for the first time.

In order to foster more domestic competition within France, Air France agreed to dispose of its 35% stake in TAT, the fourth largest French airline, by mid-1992. Further, the French charter airline market will be fully deregulated and all French airlines will be able to obtain operating licenses once they meet safety, technical and financial standards determined by France and the Commission.

The deal obliges France to liberalize its air market more and faster than under recent EC air transport deregulation (see EURECOM, July 1990). It also serves as a useful precedent for other airline mergers and alliances as Europe's air transport sector rapidly restructures.

GREEN PAPER ON STANDARDS RELEASED

In order for European firms to exploit the economies of scale resulting from the 1992 single market, the Commission believes an intensified effort to prepare European standards is needed. Hence, the Commission has sent managers of European industry a newly adopted Green Paper on standardization with this crucial message: make standardization a central element of your 1992 strategies.

The Green Paper aims to alert all concerned parties to the strategic importance for the European economy of fast and effective standardization at the European level. Because common technical specifications have become increasingly essential for international competitiveness, the Commission wants to speed up the process. And in light of the booming demand for European standards, the current system, whereby EC standards gradually replace national ones (with limited financial and human resources to meet the workload), must be more flexible.

To achieve this, the Commission suggests more direct industry participation in both the planning and preparation of industrial standards. In addition, the Commission has put forward some priorities for national and European standards bodies: more efficient methods to reduce preparation time (an average of 3 years at present); intensified links between existing European standards bodies, and, where justified, the establishment of new bodies; inclusion of other non-EC European countries in standards activities to facilitate the integration of their economies with the Community's; and more recommendations to the public authorities from the private sector vis-a-vis standards.

NEW RULES FOR CREDIT INSTITUTIONS

The Commission has adopted a directive relating to the supervision of credit institutions on a consolidated basis, representing an important technical measure for the mutual recognition of supervisory systems established in the Second Banking Directive.

Under consolidated supervision, the activities of a banking group are considered as a whole even if separate legal entities exist within the group. It ensures prudent supervision of complex group structures (which are often multinational) and strengthens the soundness of the EC's banking system.

The legislation aims to give banking supervisory authorities a clearer picture of the solvency of credit institutions belonging to a group, thereby reinforcing the protection of EC depositors.

The new proposal will replace a 1983 directive that covers only banking groups whose parent company is a credit institution. It revises the 1983 legislation in four major ways: where the parent of a group is not a credit institution but a "financial holding company", it obliges supervision of banking activity on a consolidated basis; where the parent is a "mixed-activity holding company", the holding company and the non-banking subsidiaries must provide any information requested by the supervisory authorities of the credit institutions within the group; it specifies the areas covered by supervision on a consolidated basis (e.g. solvency, limits on large exposures); and it defines the applicable consolidation methods in light of the legislative progress on consolidated accounts of credit and other financial institutions.

QUOTES

"We need efficient means to assert our common interests in the world. Our partners and friends all over the world justifiably wait for Europe to speak with one voice." German Chancellor ***Helmut Kohl*** *and Italian Prime Minister* ***Giulio Andreotti*** *in a joint statement.*

"The question is not whether we are Europeans and keen Europeans; we are. It is a question of what sort of Europe we want." UK Prime Minister ***Margaret Thatcher.***

"The present exchange rate obstacles are the last great barrier to all European firms — from the great transnational companies to the smallest one-man business — preventing them from exploiting the full benefits of the Community's internal market. They must be overcome." EC Commissioner ***Sir Leon Brittan.***

"Relations...between Europe and America are now entering a new phase. Europe's growing together must and will not make the Atlantic wider. On the contrary, we will move closer together." German Foreign Minister ***Hans-Dietrich Genscher.***

"The government will place great weight on the future of the... negotiations between EFTA and EC nations. Norway must take part in the negotiations without fixing preconditions about maintaining discriminating rules towards other countries' citizens." Norway's "new" three-time Prime Minister ***Gro Harlem Brundtland*** *commenting on the EFTA - EC negotiations for a "European Economic Area".*

"NO ALTERNATIVE TO OPEN MARKETS"

In its first ever attempt to define a general industrial policy, the Commission rejects protectionism in a paper sponsored by EC Industry Commissioner Martin Bangemann. Taking a middle path between those who see industrial policy as a panacea for business problems and those who see it as a "mortal sin", the report emphasizes that creating a sound economic environment for companies through initiatives like the 1992 single market program is the best industrial policy.

To get the most out of the larger market, Commissioner Bangemann stated that import quotas should be scrapped, quality improved, and public procurement markets effectively opened. "There is no alternative to the concept of open markets," he said.

The Commission agrees that the over 2,000 national quotas on third-country goods within the Community are incompatible with the single market program. If eliminating quotas requires structural adjustments, the EC might offer transitional aid from its social or regional funds, but the Commission rejects subsidies to sustain non-viable enterprises. Further, the Commission calls on its trading partners to reduce industrial subsidies so that the Community can continue to pare state aids at the national level.

Bangemann also announced that he is forming a committee of EC Commissioners to plan "a technological offensive" to help European industry keep up with Japan and the US.

BRITTAN ANSWERS DOUBTS ON MERGER REGULATION

At the heart of the EC's new merger control regulation (see EURECOM, August/September 1990) is the "one-stop-shop" concept, which is designed to lighten the bureaucratic load on merging companies, laying down a strict timetable for decisions and removing many of the uncertainties which have existed until now. Still, there have been criticisms that the regulation's two exceptions — where a deal threatens to create a dominant position within the territory of one member state or where there is a strictly defined public interest — provide loopholes to the one-stop principle, and will lead to delays and to "double jeopardy" at the national level.

EC Competition Commissioner Sir Leon Brittan has addressed these criticisms. Concerning the first so-called loophole, the Commission can agree with a member state that a merger is a threat to competition within its own territory and refer the case to the national authorities, but it is under no obligation to do so. According to Sir Leon, the Commission may, even if it agrees with a member state that there is a threat to competition in the territory concerned, decide to take on the case itself by applying the normal rules of regulation without referral to the national authorities. On the other hand, the Commission may disagree with a member state's argument because, for example, it does not accept that the national territory is a

relevant market in competition policy terms. The Commission is "firmly in the driving seat in deciding whether or not a case is better dealt with at a Community or national level."

The second perceived "violation" of the one-stop principle is the public interest exemption on non-competition grounds, which, contrary to popular belief, is not general in nature. In discussions with the member states, three exemption areas have been identified: public security, plurality of media and prudential rules for financial services. Although these areas are not exhaustive (others could arise over time), they set parameters. And within these parameters, the Commission remains in charge of the authorization procedures and will accept intervention by governments only where it is compatible with the regulation's underlying principles and EC law more generally. Said Sir Leon: "it is perfectly clear that this is not a general loophole...It most certainly does not enable a member state...to stop any merger it disapproves of by simply claiming that it has a legitimate interest to object to the merger."

...IN BRIEF

...In a recent poll conducted by the Association for European Monetary Union and EOS-Gallup Europe, majorities in 9 of 12 member states favor the replacement of their national currency with the ecu in five or six years' time. Overall, 61% backed the ecu compared with 39% against. Only 37% in the UK voted for replacing sterling.

...Eurostat reports that average year-on-year inflation in the EC rose 0.7% to 6.1% in September — the highest annual rate since July 1985 — as a result of the oil price surge. This compares with an August rate of 5.9%. Since the beginning of the year, consumer prices for the Community as a whole have climbed by 4.8% compared with 3.9% last year.

...European companies have been far more active than Japanese firms in acquiring US companies according to a report by KPMG Peat Marwick. During the first nine months of this year, European acquisitions totaled $24.4 billion, almost five times the Japanese purchases of $5 billion. The value of European deals also greatly exceeded Japanese purchases in 1989 ($33.3 billion compared with $12.72 billion).

...The US Council for International Business has published a business guide on the European Community entitled "The Corporate Handbook to the European Community". Interested companies should contact Eileen Murray at the Council, (212) 354-4480.

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If you would like additional information on any article in this issue, please write or telephone Christopher Matthews or Kerstin Erickson at (212) 371-3804.

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