

Europe's new currency

On January 1, 2002, the euro entered into circulation in twelve EU countries that are part of the Eurozone. As a candidate country for EU membership, Malta too is accepting to adopt the euro after it joins the EU. Negotiations between Malta and the EU on this area were closed in November 2000.

By FABIO PIROTTA, MIC Information Officer

Making history

The introduction of a single currency in twelve member states of the European Union was a historic moment for Europe. Although this is not the first time that Europe has a single currency, this time the single currency was introduced through unity rather than dominion. A currency is a monetary tool that we use to buy and sell. But it is also more than that. It also has a political meaning because it is often associated with the identity of a country. The question is whether the euro will strengthen the European identity or whether it will lead to a European "state".

How the euro came about

The project that led to the euro is known as Economic and Monetary Union. It is clear that for a group of countries to have a single currency they must join their monetary policy, that is, establish a monetary union. The idea for a European single currency goes back several years. But the first real foundations for Economic and Monetary Union (EMU) were laid in 1990 when capital movements in the European Union were liberalised and later in 1993, when the Maastricht Treaty on the European Union entered into force. This treaty included details on how the project could take place and which EU countries could participate.

Although the euro entered into circulation in January 2002, it has in fact been around since January 1999. For a three year period, between 1999 and 2002, the euro was an official currency but not in circulation. It was mainly used in banking and financial transactions. The three-year period was intended to give time to the public and the commercial community to get used to the idea of a single currency. It is unlikely that the public did get used to the euro in these three years – although many had heard about it. Nevertheless, the changeover that took place in January 2002 from the old national currencies to the euro was remarkably smooth. And the acceptance of the new currency by Europeans was also beyond expectations. Old national currencies were used simultaneously with the euro for just a few weeks until they were all phased out by the end of February, 2002. Today, the euro is the only currency in the Eurozone countries.



Chronology of the Euro

1 July 1990	<ul style="list-style-type: none"> • Stage one of EMU begins • Liberalisation of capital movements
1 November 1993	<ul style="list-style-type: none"> • Composition of ECU basket is frozen • Treaty of Maastricht enters into force • Stage two of EMU begins
1 January 1994	<ul style="list-style-type: none"> • European Monetary Institute (EMI) set up in Frankfurt
31 May 1995	<ul style="list-style-type: none"> • Commission adopts Green Paper on the single currency
15-16 December 1995	<ul style="list-style-type: none"> • Madrid Council adopts the name 'euro' for the single currency • Technical scenario and for introduction timetable finalised
December 1996	<ul style="list-style-type: none"> • EMI presented the designs for the new notes and coins
1 June 1998	<ul style="list-style-type: none"> • Establishment of the European Central Bank (ECB) • Establishment of the Organisation of the European System of Central Banks (ESCB) • Liquidation of EMI
1 January 1999	<ul style="list-style-type: none"> • Stage three of EMU begins • Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain adopt the euro • The conversion rates of these states irrevocably fixed both among themselves and the euro • ECU ceases to exist
1 January 2001	<ul style="list-style-type: none"> • Greece adopts the euro
1 January 2002	<ul style="list-style-type: none"> • Euro notes and coins enter into circulation • National currencies retrieved
28 February 2002	<ul style="list-style-type: none"> • Change over complete

Countries adopting the euro

Initially eleven out of fifteen countries of the European Union adopted the euro in 1999. These were Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain. Greece joined in 2001 becoming the twelfth member of the Eurozone. Another three EU countries, the UK, Denmark and Sweden, have so far remained out. Denmark rejected the adoption of the euro in a referendum that was held in September 2000.

The Convergence Criteria

For a country to adopt the euro as its currency it must satisfy a set of criteria. Participation in the Economic and Monetary Union (EMU) is open to countries that are part of the EU. This means that the first condition is for the country to be part of the EU. Beyond that, it must have participated for at least two years in the EU's Exchange Rate Mechanism (ERM II) which links "pre-in" currencies with the euro. The mechanism seeks to speed convergence of the currencies of those countries that want to join the Eurozone. The fluctuation margin is a standard band of plus or minus 15%. The sta-

bility of this system depends on the macroeconomic stability of each of the currencies involved.

Countries that want to participate in EMU must also ensure that their central bank acts independently. Furthermore, countries that want to join EMU must satisfy a set of criteria that seek to ensure that they have sound economic and fiscal management. These relate to the rate of inflation, long-term interest but also to the level of the public budget deficit and of the public debt.

The European Central Bank

Economic and Monetary Union led to the setting up of a European Central Bank (ECB). The ECB was set up in 1998 and its independence is guaranteed by the EU Treaty. The first President of the ECB was a Dutch national, Wim Duisenberg.

The ECB is responsible for monetary policy in the Eurozone countries and its principle task is to ensure that there is price stability. It works through a Governing Council which consists of the Executive Board of the ECB and the governors of the national central banks of each of the Eurozone countries.

Rate of inflation	Long-term interest rate	Budget deficit	Public debt
+/- 1.5% points of the average of the three best-performing states	+/- 2% points of the average of the three best-performing states	Less than 3% of GDP	Less than 60% of GDP



This council formulates monetary policy and takes decisions relating to interest rates. These decisions have a direct influence on the rate of interest that consumers in Eurozone countries pay on their loans and the rate of interest that they gain on their deposits.

The ECB has an Executive Board which implements the monetary policy decided by the council and conducts day-to-day business. The ECB also has a General Council which also includes the governors of the central banks of the EU countries that are not members of the Eurozone.

The setting up of the European Central Bank does not mean that national central banks are now redundant and may close down. Quite the contrary, they have a role and they are still required in order to ensure that the common monetary policy is adequately implemented at national level. National central banks are part of the European System of Central Banks (ESCB) which is at the heart of the decision-making on monetary policy. Before joining EMU, Luxembourg was already part of a monetary union with Belgium and did not have a national central bank. But in order to participate in EMU, Luxembourg set up its own national central bank and can now participate in the European System of Central Banks (ESCB).

Membership will also mean adopting the euro

Countries that join the EU are expected to adopt the euro at some point after they become members of the EU. During negotiations on this area, Malta expressed its interest to participate in EMU and adopt the euro as soon as possible after EU membership. Even before membership, Malta has started its preparatory work towards the eventual adoption of the euro after accession. Amongst other things, the Maltese Government has projected a reduction in its budget deficit by 2004. However, there is no specific timeframe as to when a new EU country can adopt the euro. As things stand today, this can only happen after at least two years of EU membership. But it could take longer.

The National Central Bank

The system of the euro is set up in such a way that both the National Central Banks (NCBs) and the European Central Bank (ECB) are independent. During the course of their work, neither the ECB, nor a NCB, nor any member of their decision-making bodies may take instructions from any external body. None of the EU institutions and bodies and/or the governments of the EU Member States may try to influence the members of the decision-making bodies of the ECB or of the NCBs in the performance of their tasks.

This means that the Central Bank of Malta will have greater autonomy. This is already being sought prior to EU accession because it in itself is considered as a more effective way of attaining macro-economic stability. Like the European Central Bank, its main objective will focus on the need for price stability. This means that keeping inflation low will be its most important responsibility.

Upon Malta's entry in EMU and adoption of the euro, the Central Bank of Malta will also become part of the European System of Central Banks (ESCB) which is responsible for monetary policy in the Eurozone along with the European Central Bank.

The administrative structure of the Central Bank of Malta is also being modified to guarantee greater independence from government and to achieve the aim of price stability.



The Governor and Directors of the Bank must be appointed for a minimum period of five years and must be selected from within the Bank itself. This ensures that, for instance, there need be no change in monetary policy simply because of a change in government.

Stricter controls on public financing

In principle, the Central Bank of Malta cannot finance the country's public deficit or grant public sector institutions privileged access to credit. For this reason, the Minister of Finance issued a Legal Notice in 1999 to prevent Government from obtaining overdraft facilities from the Central Bank. This implies stricter controls on public financing.

What will happen to the Maltese Lira?

Currently, Malta has a fixed exchange rate system. The value of the Maltese Lira (Lm) is pegged to a basket of currencies that is composed roughly of 56% the euro, 22% the UK Pound Sterling and 22% the US Dollar. It is expected that eventually the Lira will be linked more closely to the euro. Malta's interest rates are already currently more or less in line with Eurozone rates. In the future it might be that the euro component in the Lira may be increased.

The fact that Malta is pursuing membership of the Eurozone means that eventually the Maltese Lira will be replaced by the euro. Malta's monetary policy will be shared with other Eurozone countries and like other Eurozone countries Malta will no longer be able to, for

instance, decide to devalue its currency. On the other hand, the Central Bank of Malta would be part of the European System of Central Banks (ESCB) and would participate in the shaping of the euro monetary policy.

The decision to give up one's currency to adopt a common currency is often seen as affecting sovereignty. And this is true. There is a trade-off between giving up sole sovereignty to decide over one's own currency and sharing in the wider sovereignty of a greater currency that is used by several other countries. One must also bear in mind the extent of sovereignty that we have on the Maltese Lira today, taking into account its linkage to foreign currencies.

MIC publications on the euro

The Malta-EU Information Centre (MIC) has produced two publications giving practical information on the euro, including how it looks, the countries that use it and its security features. These are: *Mistoqsija u Twegiba dwar l-euro* and *L-euro għall-Maltin li se jsiefru*. Copies of these publications are available from MIC free of charge.

More information

A great deal of additional information on the euro and on Economic and Monetary Union may be obtained from the following website:
www.mic.org.mt/EUINFO/subjects/EMU/emu.htm



Malta's official negotiating position paper on this area is also available from MIC or from:
www.mic.org.mt

Tel: 25 90 91 92 e-mail: euinfo.mic@magnet.mt

Subscribe to the weekly bulletin of Aggornat by contacting MIC