THE IMPACT OF THE EURO ON IFAD

Introduction

1. In anticipation of the launching of the European Monetary Union (EMU) on 1 January 1999, the management of IFAD appointed a consultant to prepare a study on issues that may impact IFAD, both internally and externally, with a view to assessing the risks that may be faced and the best way to proceed. The consultant conducted extensive interviews with key IFAD staff. He was expected to present a draft report to management by the end of November 1998.

2. The present document is placed before the Executive Board for the purpose of providing information on the basic aspects of the EMU. More details on this important issue will be provided to the Executive Board once the consultant’s report has been reviewed.

3. The meeting of the European Council of Head of States or Governments on 2-3 May 1998 decided on the first wave of 11 countries to join the EMU as founding members, namely, Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, The Netherlands, Portugal and Spain. Denmark, Sweden and the United Kingdom have opted not to join at this stage. Greece was judged as not yet ready to join the EMU.

The Maastricht Convergence Criteria

4. Four criteria to be met by countries striving to join the EMU in the first wave were established at the Maastricht conference in 1991.

   (a) Price Stability

       Average rate of price inflation, over the previous year prior to joining the EMU, of not more than 1.5% points above that of the three best-performing Member States in terms of price stability.
(b) Sustainable Government Financial Position

The ratio of the general government annual budget deficit to gross domestic product (GDP) should not be greater than 3%. Exceptions to this criterion are allowed, provided the annual budget deficit has declined substantially and continually and comes closer to 3% or the excess is only exceptional and temporary and the ratio remains close to 3%. Additionally, the ratio of government debt to GDP must not exceed 60% unless it is substantially diminishing and approaching 60% at a satisfactory pace.

(c) Convergence of Interest Rates

The average nominal long-term interest rate over the year prior to joining the EMU must not be more than two percentage points above that of the three best-performing Member States in terms of price stability.

(d) Exchange Rate Stability

Participation in the Exchange Rate Mechanism (ERM) of the European Monetary System (EMS), respecting the normal margins of fluctuation for at least two years without a need for devaluation. There will be a new exchange rate system to ensure exchange rate stability between the euro and the next possible new wave of participants.

The Changeover Scenario: 1 January 1999 to 1 July 2002

5. The European Central Bank (ECB) and the European System of Central Banks (ESCB) were founded on 1 January 1998 and will be fully operational on 1 January 1999. According to the Maastricht Treaty, the primary objective of the ECB and the ESCB is to maintain price stability. The ECB, an entity independent of national central banks, will support the general economic policies in the EMU community to the extent this function is compatible with maintaining price stability. As of 1 January 1999, all monetary aspects of the EMU will be vested with the Governing Council of the ECB which comprises the Executive Board of the ECB and 11 EMU Members represented by the respective governors of national central banks. This Governing Council replaces the monetary decision-making bodies in EMU Members States, such as national central banks.

6. The ESCB consists of the six-member Executive Board of representatives of the ECB and national central banks of all the European Union (EU) Member States.

7. As of 1 January 1999, the date the EMU is to be launched, and for a period of three years, the following changeover will take place:

   (a) irrevocable fixing of the conversion rates between the Euro and the national currencies;
   
   (b) ECB assumes the responsibility for monetary policy;
   
   (c) introduction of the euro as book money;
   
   (d) as of 1 January 1999, all new government debts will be issued in, and all outstanding government debts will be converted to, euro;
(e) the rest of the changeover in the non-cash area is left to market forces (no compulsion, no prohibition) (see paragraph 11 (b) below); and

(f) the public sector, companies and households must complete changeover by the end of 2001.

8. The actions mentioned in points (a), (b), (c) and (d) above will take effect on 1 January 1999.

9. As of 1 January 2002, and for a period of six months:

(a) euro bank notes and coins will be introduced as legal tender;

(b) national bank notes and coins will cease to be legal tender by 1 July 2002 at the latest, but may still be exchanged for the euro; and

(c) length of cash changeover may vary from one country to another.

Issues of Concern

10. While the money, foreign exchange, equity and bond markets will switch to euro on 1 January 1999, banking for individuals probably will continue to be conducted in local currencies up to the final changeover date. Corporate banking may start using the euro at an earlier date.

11. At the EU level, two regulations are relevant:

(a) Article 235 of the EU Treaty on “certain provisions relating to the introduction of the euro (Council Regulation (EC) No. 1103/97)” took effect on 20 June 1997 and applies to all EU countries. A major component of the regulation is the confirmation of the legal principle of the continuity of contracts, i.e., existing contracts will remain in force with all rights and obligations, provided no other agreement has been made after the advent of the new currency. The introduction of the euro will not result in the frustration of contracts and cannot be used as a pretext for unilateral adjustment or termination of contracts, and will not, in principle, constitute grounds for unilateral adjusting. However, contracts with non-EU countries or those concluded under non-EU law, may require examination. Additionally, with the exception of ECU contracts that will automatically convert into euro at 1:1, contracts in national currencies will not automatically convert to euro. Legislation and regulations to assume continuity of contracts exist in all EU jurisdictions as well as in the States of New York and Illinois in the United States of America.

(b) Article 109 of the Treaty on the Introduction of the Euro (Council Regulation (EC) No. 974/98) was approved in May 1998. This regulation relates to what is known as the principle of “no compulsion, no prohibition” and, in effect, stipulates that anyone who wishes to use the euro during the 1 January 1999–31 December 2001 transitional period may do so but that no one is obliged to. New contracts and other legal instruments may be denominated either in national currency or in euro.

12. Conversion rates for the euro expressed in national currency will be fixed permanently on 31 December 1998, to six significant places, e.g., Euro 1 = DEM 1.99899. These rates, which must not be rounded up, will be used to convert monetary amounts from national currency into euro and vice versa.
13. For funds to be converted from one participating currency (e.g., Italian lire) into another (e.g., French francs), they must be first converted into euro amounts, rounded up to no less than three decimal places, and then converted into the other national currency using the permanent exchange rate.

Conclusions

14. IFAD’s Office of the General Counsel is reviewing contracts with non-EU countries or under non-EU law with respect to their continuity and the eventual effect of the introduction of the euro on the use of the Special Drawing Right for IFAD’s loan agreements.

15. Staff of IFAD Treasury and the Controllers’ Office have reached agreement with IFAD’s global custodian on the procedure for converting the EMU Member Bonds held in IFAD’s portfolio into euro on 1 January 1999.

16. The principle of “no compulsion, no prohibition” during the transitional period will enable IFAD to plan and stagger courses of action in a manner most beneficial to the Fund.

17. Since 1 January 1999 triggers the introduction of the euro as book money, the change over of IFAD’s bank accounts to euro need not be of immediate urgency. This will provide the Fund with lead time to rethink and streamline some of its financial operations and relations with banks and other entities.