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EMU AND TRANSATLANTIC ECONOMIC RELATIONS

Peter B. Kenen

Introduction

When I wrote my book on EMU four years ago (Kenen 1995), very little had been written on the international dimensions of EMU. There was a chapter in the Commission's path-breaking study (European Commission, 1990). There were papers by Alogoskoufis and Portes (1991, 1992), Cooper (1992), Goodhart (1992), Mundell (1993), and Williamson (1992), and there were a few working papers by economists at the Board of Governors of the Federal Reserve System (Edison and Kole, 1994; Johnson, 1994; and Leahy, 1994), but little else. The literature has grown hugely in the last two years, however, and it is hard to say something new about the whole subject or the narrower topic covered by this paper. As I cannot be very original, I will try at least to be controversial--to suggest that EMU will not dramatically alter the economic environment or lead, as some believe, to large changes in existing institutions.

This paper has three main parts. The first part deals with attitudes toward EMU in the United States. It is addressed to European readers who believe that American academics and officials are indifferent or hostile to EMU. The second part asks how EMU may affect the monetary and economic environment and how the new environment may affect transatlantic cooperation. The third part looks at institutional arrangements. It does not deal with the complex problems posed by EMU for the International Monetary Fund; it focuses instead on the membership and functioning of the G-7 and G-10, the two informal groups that provide the frame-work for cooperation among the major industrial countries.¹ (This part of the paper has benefitted from the meeting of a workshop at Princeton University in April 1998, where academics and officials from Europe, the United States, and Japan discussed the implications of EMU for international economic cooperation.)

1 The G-7 includes Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States; the G-10 includes those seven countries plus Belgium, the Netherlands, Sweden, and Switzerland and thus has eleven members, rather than ten. The summit-level meetings of the G-7 also include Russia and the President of the European Commission.

Attitudes Toward EMU in the United States

Europeans often ask why many Americans, including American officials, seem to have little interest in EMU and why many American academics are skeptical or hostile. The answer has several parts.

Europeans and Americans have different views about the importance of EMU for the United States. Europeans believe--or hope--that EMU will give Europe more influence over the management of the international monetary system. Europe will speak with one voice, it is said, and the rest of the world will listen closely. Furthermore, the euro will be a world-class currency, reducing the role of the dollar and, therefore, the influence of the United States. On this view, American officials *should* be apprehensive about EMU but conceal their concern by feigning indifference instead.² This paper will argue, however, that the euro will not greatly reduce the international role of the dollar. In my view, moreover, the role of the dollar does not explain the influence of the United States or the large role of American financial institutions in international markets.

Europeans must take some responsibility for the low-keyed approach adopted by American officials. What some Europeans interpret as covert antipathy is, in fact, frustration. European officials have been very slow to answer the questions most often asked by outsiders. They promise to speak with one voice on matters of common concern but have just begun to resolve the complex institutional issues involved.

If Europeans interpret American views in light of their own expectations about the worldwide impact of EMU, Americans tend to evaluate EMU in light of their own preconceptions. Because they hear repeatedly that EMU is a political project--a vehicle for promoting political integration--they conclude that there is no economic rationale for EMU. Europeans are partly responsible for this mis-conception. Helmut Kohl has made some extravagant claims for EMU--which he may truly believe--and they have inspired extravagant rejoinders on my side of the Atlantic, such as the warning by Feldstein (1997) that EMU might lead to war in Europe, not to perpetual peace. More generally, Europeans and Americans both fail to distinguish between two very different statements --the normative judgment that EMU will be beneficial insofar as it contributes to political

2 Thus, Portes and Rey (1998) quote assurances by Lawrence Summers, Deputy Secretary of the U.S. Treasury, and Jeffrey Frankel, a member of the Council of Economic Advisers, that the euro will not displace the dollar, and suggest that the wish may be father to the thought.

integration, and the less controversial positive judgment that the imminent arrival of EMU must be ascribed to the political commitment of European leaders, not to the intrinsic strength of the economic case for EMU.

To complicate matters, too few Americans understand the economic case for EMU, and I must take some of the blame, for having helped to develop the theory of optimum currency areas (Kenen, 1969). Europe falls short of being an optimum currency area; it has too little wage flexibility, too little cross-border labor mobility, and no fiscal mechanism for making endogenous transfers to dampen the effects of asymmetric shocks. It is hard to believe, moreover, that EMU itself will induce European governments to deal effectively with these defects.

The theory of optimum currency areas, however, is really concerned with the choice between floating and fixed exchange rates, and that is not the choice at issue. It is the more limited choice between the quasi-fixed exchange rates of the European Monetary System (EMS) and the irrevocably fixed exchange rates of the Maastricht Treaty. European countries are too closely integrated to tolerate the side effects of exchange-rate fluctuations, and floating rates might under-mine the rules of the single market. By committing themselves to exchange-rate stability, however, the EU countries agreed in effect to abandon independent monetary policies. Accordingly, they had to choose between a single monetary made by the Bundesbank and thus suited to the needs of the German economy and a policy made by a European institution and thus suited to the needs of Europe as a whole. At Maastricht, they shifted from one to the other. They did not object to the Bundesbank's policy preferences. On the contrary, they reproduced them in the Maastricht Treaty. They objected instead to its policy domain, which caused it to ignore the needs of other EU countries.³

The Outlook for Economic Cooperation

Before asking how EMU might influence economic cooperation between Europe and the United States, we should perhaps remind ourselves that cooperation can take many forms. A decade ago, there was a flurry of interest in the coordination of national policies--in the mutual modification of national policies, especially monetary and fiscal policies. But various reasons were given.

3 On the case against exchange-rate flexibility in Europe, see Eichengreen (1996); on the distinction between policy domains and policy preferences, see Kenen (1997).

The academic literature was mainly concerned with what I described at the time (Kenen, 1990) as policy-optimizing coordination--making explicit bargains about the setting of policy instruments. Using simple game-theoretic models and abstracting from various sorts of uncertainty, it can be shown that this sort of cooperative behavior dominates noncooperative behavior; each participating country can be expected to improve its own economic performance, measured in terms its own policy objectives. (But efforts to measure the gains from coordination taught us a curious lesson. The gains obtained by moving from actual policies to optimal but noncooperative policies are usually larger than the gains from taking the next step and moving to fully cooperative policies. We should perhaps have paused to ask why governments persist in pursuing grossly nonoptimal policies.)

Another body of literature dealt with a more limited form of coordination aimed at exchange-rate stabilization or, at least, the avoidance of exchange-rate misalignments. For some, such as Williamson and Miller (1987), this was a second-best way to improve economic performance--a rule-based way to appropriate some of the gains from policy-optimizing coordination--as well as a way to prevent large exchange-rate movements like those that of the 1980s. For others, exchange-rate stabilization *per se* was the main objective.

It was clear at the time, however, that governments were not paying much attention to the academic literature. Had they been reading what economists were writing, they would have engaged in continuous coordination--making new policy bargains at frequent intervals or following policy rules like those proposed by Williamson and Miller. Coordination was episodic, and it rarely involved mutually agreed modifications in the participants' policies. When there was an explicit bargain, moreover, it was likely to cover disparate policies. At the Bonn Summit of 1978, Germany and Japan agreed to make fiscal-policy changes, but the United States agreed to deregulate domestic energy prices. Hence, I was led to suggest that policy coordination should be interpreted differently--as a way to defend the international economic order from economic and political threats, not as a way to improve economic performance or foster exchange-rate stability.

This regime-preserving interpretation is, I believe, the most sensible way to explain the Plaza Accord of 1985, which was meant to quell the resurgence of protectionism in the United States resulting from the sharp appreciation of the dollar in the early 1980s. It is

likewise the best way to explain the collective response of the major industrial countries to the debt crisis of the 1980s and their response to the Asian crisis of 1997--including the recent efforts of the United States to elicit a large fiscal-policy change from Japan.

When coordination is interpreted this way, of course, the boundary between coordination and looser forms of economic cooperation becomes somewhat porous. There is little operational difference between an *ad hoc* agreement among the G-7 countries aimed at resolving a problem internal to their own economic relations and an agreement aimed at resolving a crisis in Asia or Latin America. The G-7 agenda is currently dominated by external issues--reflecting the need for a new "international architecture" to cope with the difficult problems posed by the globalization of financial markets.

If the principal issues facing the major industrial countries are not those posed by EMU or the prospective role of the euro, there may little incentive for European countries or their G-7 partners to make major modifications in the way they deal with each other--to shrink the G-7 into a G-3 or consolidate European membership in the International Monetary Fund. In fact, some EU countries may not want Europe to speak with one voice on the issues most likely to occupy the major industrial countries during the next few years.

I have another reason for taking this view. The effects of EMU on Europe itself will diminish the need for policy coordination in the strict sense--for policy bargains between the euro-area countries and the United States.

When the Commission launched the debate about the international impact of EMU, it argued that EMU would lead to more intensive coordination by replacing an asymmetric, dollar-dominated regime with a more symmetric multipolar regime. At present, it said, Europe comprises a group of medium-sized policy centers, and the spillover effects of their economic policies are much smaller than those of U.S. policies. Under this asymmetric regime, the United States has less to gain from policy coordination, and it can even exploit the situation by choosing its policies unilaterally without fear of similar behavior by Europe. The Commission acknowledged the familiar objections to a multipolar system--that it is unstable and leaderless. It conceded the need for leadership but said that a symmetric system would provide better leadership; governments would have to compete for leadership by improving their own policies (European Commission, 1990, p. 195).

Clearly, the Commission's view was based on the policy-optimizing approach to coordination. It argued, in effect, that a more symmetric relationship between the United States and Europe would give each side the incentive and ability to influence the other--to insist that its partner internalize the spillover effects of its policies. I have already suggested, however, that policy coordination is rarely driven by policy optimization. It has been mainly aimed at containing or reversing large exchange-rate movements.⁴

How, then, will EMU affect exchange-rate behavior and the willingness of European countries to combat large exchange-rate movements.

Let us look first at exchange-rate behavior and set aside temporarily the usual question about the short run--whether the euro will be strong or weak in the early years of EMU. What can be said about the variability of the nominal exchange rate between the dollar and the euro? Will it be larger or smaller than the variability of the exchange rate between the dollar and the deutsche mark? Those who have studied this question carefully conclude that the dollar-euro rate will be more volatile, although the outcome will depend in part on the nature of the shocks affecting the countries involved and the strategy adopted by the European Central Bank (ECB) to implement its monetary policy; see Bénassy Quéré *et al.* (1997), Masson and Turtelboom (1997), and Bryant (1997).

The euro area, however, will be less sensitive to exchange-rate variability than its members have been heretofore, though not for the reason usually given, that the euro area as a whole will be less open and thus less exposed to the real effects of exchange-rate changes. The coming of EMU will domesticate trade within the euro area, but it will not affect the openness of individual EU countries to the rest of the world or, for that matter, the openness of the whole euro area. When EMU replaces the EMS, however, no European country will have to incur the economic costs of defending its exchange rate by tightening its monetary policy.

Recall the story often told about exchange-rate tensions in the EMS. When the deutsche mark appreciates against the dollar, it drags along the other EMS currencies. They

4 The Commission's analysis also depends implicitly on the assumption that there has been no coordination among EU countries. If they had followed similar policies, the spillover effects of their policies would have been similar in size to those of U.S. policies. Yet there was something close to a common monetary policy under the EMS, as European central banks had to mimic the Bundesbank's monetary policy. Furthermore, the United States, rather than being indifferent, was often the main advocate of policy coordination; see Goodhart (1992).

appreciate against the dollar but tend to depreciate against the mark, and their countries have two problems. First, their industries become less competitive *vis-à-vis* the outside world. Second, they are obliged to defend their currencies within the EMS by intervening on foreign-exchange markets and raising domestic interest rates. Both of these effects, the exchange-rate change and the interest-rate change, reduce output and employment. This so-called mark-dollar polarity played a role in the EMS crisis of 1992 and in other episodes.

The advent of EMU will not eliminate the problem completely. It will not reduce the exposure of individual countries to foreign competition, as it will not affect their openness to the outside world. They will therefore continue to experience reductions in output and employment when the euro appreciates against the dollar. But the rest of the story will change. No euro-area government will be obliged to defend its currency by tightening its monetary policy; it will have no currency to defend and no monetary policy of its own. Furthermore, the ECB, having the whole euro area as its policy domain, may be willing to limit the appreciation of the euro by easing its monetary policy, whereas the Bundesbank, having a narrower domain, might not have done so. This point appears frequently in the recent literature but is not made carefully. It has nothing to do with the domestication of intra-EU trade and the apparent reduction in the openness of the EU countries taken as a group. It speaks to the main effect of EMU itself--the elimination of bilateral exchange rates within the euro area.

The coming of EMU may have another effect on transatlantic cooperation. The euro will become a world-class currency, sooner or later, and international financial markets may be affected more strongly by the ECB's monetary policy than by the effects of the Bundesbank's policy.

Views about the future role of the euro differ in three dimensions--the role it will play eventually, the speed with which it will acquire that role, and the implications for exchange-rate behavior during and after the transition. At one extreme, Cooper (1992, 1997) believes that the effects will be slow and small and that the dollar will continue to be the main international currency. At the other extreme, Bergsten (1997) believes that the effects will be large and swift; he predicts a quick shift in private and official portfolios, amounting perhaps to \$1 trillion, causing the euro to appreciate sharply in the early years of EMU. Others expect more gradual growth in the role of the euro and are less certain about the exchange-rate effects. McCauley (1997) points out, for example, that the euro could attract more borrowers than lenders, causing the supply of euro-

denominated debt to outrun the demand and thus causing the euro to depreciate in the early years of EMU.⁵

Let's look at matters chronologically. In the absence of any sudden change in economic fundamentals, the euro should be fairly strong in the first year of EMU, compared to the recent behavior of the deutsche mark, and it may strengthen thereafter. Of the three forces affecting its short-run behavior, the monetary policy of the ECB, shifts in private and official portfolios, and concerns about the durability of EMU, the first one will probably dominate. As 1999 approaches, central-bank interest rates in the euro area must converge to a common rate. The rate will be chosen by the same central-bank governors who will soon belong to the Governing Council of the ECB, and they will not knowingly choose a rate that they will have to change abruptly right after EMU begins. They want to achieve a seamless transition to EMU.

The advent of EMU will have mixed effects on the demand for the euro and, more broadly, the demand for euro-denominated assets. At present, EU currencies are held largely by EU residents. At the end of 1996, cross-border holdings of bank deposits in EU currencies, excluding sterling, amounted to \$474 billion, of which \$299 billion or 63 percent were held by EU residents.⁶ Whatever the reason for holding them, to hedge against exchange-rate risk or minimize transactions costs, some of these holdings will be redundant when they are turned into euros. Furthermore, the volume of foreign-exchange trading in the euro will be smaller, not larger, than the previous volume of trading in the national currencies of the EMU countries. In April 1995, at the time of the most recent survey by the Bank for International Settlements, transactions involving the EMS currencies amounted to \$1,099 billion per day, but \$300 billion or 27 percent involved an exchange of one EMS currency for another. These transactions will cease completely as soon as EMU begins. Finally, the reserve-currency role of the euro will be smaller than the reserve-currency role of the deutsche mark; the deutsche mark holdings of the euro-area central banks will cease to function as reserves when they turn to euros. In short, the substitution of the euro for the participants' national currencies will reduce the international role of the euro, compared to the roles of the national currencies taken as a group. The euro will become more important only insofar as EMU leads to widespread *behavioral* changes.

5 See also McCauley and White (1997).

6 All of the numbers in this paragraph come from McCauley (1997).

Three such changes are commonly mentioned. The euro may be used more widely in the invoicing and financing of international trade. It may be used more widely as a vehicle currency in the foreign-exchange market. And euro-denominated assets may be held more widely. If all of these changes occur, moreover, they could be mutually reinforcing. Portes and Rey (1998) predict that commercial and financial use of the euro will raise the volume of trading in the foreign-exchange market, reduce transactions costs, and thus lead to wide use of the euro as a vehicle currency. In fact, they go further. Theoretical work by Rey (1997) stresses the importance of network externalities and economies of scale in explaining the use of a single vehicle currency. Hence, Portes and Rey suggest--but do not predict--that the foreign-exchange market could shift abruptly from one such currency to another. The euro could become the dominant vehicle currency and, therefore, the central banks' intervention currency, which might make it, in turn, the dominant reserve currency.

This line of reasoning, however, is based on the belief that the size of the euro area will lead to widespread use of the euro in international trade and greatly raise the foreign demand for euro-denominated assets. That belief, in turn, is rooted implicitly in the supposition that EMU by itself will lead to large behavioral changes, and this supposition is tenuous. Consider, for example, the forecast that the euro will be widely used for the invoicing of international trade. Why should the mere difference in size between Germany and the euro area lead to a change in the invoicing of German trade with the Western Hemisphere? The size of the typical firm will not change nor will its market power. Consider instead the forecast that the redenomination of German and Italian bonds will unify the markets for them. The size of the typical bond issue will not change, and though the two sets of bonds will become closer substitutes when they are denominated in a single currency, the turnover in each individual issue may not rise by enough to attract big institutional investors, including central banks, that presently hold large quantities of U.S. government debt.⁷

The direction of change is not controversial. Although the beginning of EMU will, by itself, reduce the role of the euro compared to the role of the deutsche mark, its effects on behavior will, without doubt, raise the role of the euro. Nevertheless, it will take time for the ECB to acquire the credibility of the Bundesbank and for EMU itself to prove its

7 It should be noted, moreover, that EMU may not lead to a further fall in the interest-rate difference between German and Italian bonds, as there may be a high cross-country correlation between exchange-rate risk and default risk.

durability. Therefore, it will take time for the euro to replace the deutsche mark, and the euro will have to replace the deutsche mark before it can start to displace the dollar.

The Organization of Transatlantic Cooperation

Once upon a time, we found it easy to explain why certain governments got together regularly and why they were able to keep others out. It is harder now.

Consider these anomalies:

- The seven largest industrial democracies used to attend the annual economic summit. Today, they are joined by Russia, which has the world's biggest dysfunctional economy.
- A larger group of industrial countries, the G-10, is slipping into irrelevance. It used to derive legitimacy from its members' participation in the General Arrangements to Borrow (GAB). But the GAB will soon be surrounded by the New Arrangements to Borrow (NAB), with several more participants. Furthermore, the Bank for International Settlements, the institutional home of the G-10 central banks, has admitted several additional members. In 1995, the Halifax Summit asked the G-10 deputies to study some of the issues posed by the Mexican crisis. But a new *ad hoc* group, the G-22, has been asked to study the issues posed by the Asian crisis.
- Soon after joining the OECD, three of its new members--the Czech Republic, Korea, and Mexico--suffered grave banking and balance-of-payments crises.
- The eleven countries soon to join EMU are represented in the IMF by no fewer than eight Executive Directors--who also represent more than forty other countries.

Matters are not neater in Europe, though some of the anomalies encountered there may begin to disappear in the next few months. Under the Maastricht Treaty, the President of the Council of Ministers, a rotating position, will participate in the deliberations of the Governing Council of the ECB and may even submit motions for consideration. At the moment, however, the Presidency is held by the United Kingdom, which has opted out of EMU. It is expected, moreover, that the Ecofin Council will discuss matters pertaining to

EMU, including the annual report of the ECB,⁸ and countries that do not participate in EMU will not be excluded from those discussions, although they will not be able to vote on EMU-related matters.

To complicate matters, the prospective members of the monetary union have agreed to establish a council of their own, known as the Euro-X Council. It will not take decisions on matters that fall within the jurisdiction of the Ecofin Council, but its deliberations may greatly reduce the importance of the informal meetings at which the Ecofin Council does much of its real work. At this writing, moreover, the prospective EMU members have not decided who will chair the Euro-X Council and whether that task will rotate semiannually, like the EU Presidency, or perhaps less frequently.

The largest and most obdurate ambiguities, however, reside in Article 109 of the Maastricht Treaty, on exchange-rate policy and related matters. The full text is appended to this paper. The first paragraph of Article 109, on formal agreements with non-EU countries, has little relevance to the current situation. There is no interest whatsoever on either side of the Atlantic in establishing a par-value system or any other exchange-rate regime imposing obligations with regard to intervention or the conduct of domestic monetary policy. For this same reason, paragraph 3 is also irrelevant. It is cited in paragraph 1 and nowhere else, and it says that agreements concluded in accordance with it are binding on the ECB. In other words, the provisions of paragraph 3 cannot possibly apply to informal exchange-rate agreements among the key-currency countries.⁹

We are still left to wonder, however, if the language that appeared in the Plaza Accord of 1985 would now be deemed to constitute a "general orientation" for exchange-rate

8 The Ecofin Council is the name given to the Council of Ministers when it is composed of finance ministers.

9 The Commission (1997), however, has taken a different view. "The inclusion [in paragraph 3] of monetary regime matters takes account of the fact that the Community (euro area) will have exclusive competence for the negotiation of such matters, as it has for foreign exchange regime matters according to Article 109(1)." Thus, the Commission appears to be saying that paragraph 3 applies to all monetary and exchange-rate issues, whether covered by paragraph 1 or not, and that paragraph 4 applies to EMU-related issues other than monetary and exchange-rate issues. The Commission would like this to be true; paragraph 3 says that the Commission "shall be fully associated" with negotiations undertaken under that paragraph, whereas paragraph 4 does not mention the Commission. In a resolution quoted below, however, the European Council seems to equate the monetary and exchange-rate matters mentioned in paragraph 3 with the issues of particular relevance to EMU mentioned in paragraph 4, with the aim of limiting the role of the Commission and of the Ecofin Council itself.

policy (or would call for subsequent formulation of a "general orientation") under paragraph 2.¹⁰

Although the Ecofin Council has not yet taken a formal decision regarding the representation of the EU or the EMU countries in international bodies such as the G-7, the Luxembourg meeting of the European Council adopted a resolution interpreting Article 109. It affirms the primacy of the Ecofin Council over the Euro-X Council, but it says that the Ecofin Council will make only limited use of its powers under paragraph 2:

While in general exchange rates should be seen as the outcome of all other economic policies, the Council may, *in exceptional circumstances*, for example in the case of a clear misalignment, formulate general orientations for exchange-rate policy in relation to non-EC currencies [emphasis added].

The resolution also seeks to clarify the division of responsibility between the Ecofin Council and national governments. The Council, it says, should decide the Community's position "on issues of particular relevance to economic and monetary union," and the Council's decisions will apply both to bilateral relations with other countries and to proceedings in international organizations and informal groups. On matters "other than monetary and exchange rate policy," however, the individual EU governments "should continue to present their policies outside the Community framework, while taking full account of the Community interest." Thus, the European Council has sought to limit the scope of collective decision-making by taking the "monetary or foreign-exchange regime matters" cited in paragraph 3 of Article 109 to be coextensive with the "issues of particular relevance to economic and monetary union" cited in paragraph 4.

I can best sum up by asking whether the advent of EMU can be expected to cause any significant change in the organization of economic cooperation among the major industrial countries. Will it lead, for example, to the consolidation of the G-7 into a

10 The Plaza Accord was adopted by the finance ministers and central bank governors of France, Germany, Japan, the United Kingdom and the United States, and this is the text of the final paragraph:

The Ministers and Governors agreed that exchange rates should play a role in adjusting external imbalances. In order to do this, exchange rates should better reflect fundamental economic conditions than has been the case. They believe that agreed policy actions must be implemented and reinforced to improve the fundamentals further, and that in view of the present and prospective change in fundamentals, some further orderly appreciation of the main non-dollar currencies against the dollar is desirable. They stand ready to cooperate more closely to encourage this when to do so would be helpful.

compact G-3? My answer is "no, not now, or for the foreseeable future." There are three reasons. First, the G-7 countries will have to go on dealing with "external" issues, such as the ramifications of the Asian crisis, and the EU countries are not required or willing to speak with one voice on those issues. Second, the United States and Europe will not pay close attention to the old "internal" issue--exchange-rate management. The dollar-euro rate will matter less for the United States, economically and politically, than the dollar-yen rate, and it will matter less for Europe than the old dollar-mark rate. Third, the European Council has affirmed the distinction made in the Maastricht Treaty-- the distinction between exchange-rate and monetary policy, on the one hand, and economic policy, on the other. Europe will speak with one voice on exchange-rate and monetary policy, but the national governments will speak for themselves on economic policy--including, of course, fiscal policy. Although the Ecofin Council will coordinate fiscal policies within the euro area, it will not even serve as the spokesman for those policies in international bodies.

Turning from substance to process, Europe will have no trouble making the change in representation that is, in fact, required by the Maastricht Treaty. The ECB will participate fully in G-7 meetings. But Europe may not be willing to take the next step--to tell the Bundesbank, the Bank de France, and the Banca d'Italia to stay away. The Bank of England, after all, cannot be told to stay away. And the representation of the Ecofin Council poses more difficult issues. How will it be represented when the EU Presidency is held by a non-EMU country or, for that matter, an EMU country that is not a G-7 country? Furthermore, the President of the ECB will be regarded as a principal, free to make binding commitments, but an Ecofin representative will be just that--an ambassador speaking from a brief, even when it is the finance minister of a G-7 country.¹¹

The solution proposed by Henning (1997), the creation of a "monetary G-3" to deal with exchange-rate and monetary issues, does not address these problems effectively. First, it is based on the dubious supposition that Japan, Europe, and the United States are--or should be--committed strongly to exchange-rate stability. Second, it is politically unrealistic. The EU countries may agree to Ecofin representation at G-7 meetings along with national representation. They are less likely to agree to Ecofin representation at G-3 meetings in lieu of national representation. Finally, it is cumbersome. No one will gladly consent to another set of meetings. There are too many now. I am thus inclined to agree

11 The same point was made by several participants in the recent Princeton workshop, and some went on to note that, in this and other ways, EMU will bolster the influence and operational independence of central banks at the expense of finance ministries.

with Begg *et al.* (1997). "The solution," they say, "is messy but inevitable: to increase the number of participants in G-7 meetings, not reduce them."

Article 109 of the Treaty on European Union

1. By way of derogation from Article 228 [on making agreements with international organizations and other states], the Council may, acting unanimously on a recommendation from the ECB or from the Commission, and after consulting the ECB in an endeavour to reach a consensus consistent with the objective of price stability, after consulting the European Parliament, in accordance with the procedure in paragraph 3 for determining the arrangements, conclude formal agreements on an exchange-rate system for the ECU [euro] in relation to non-Community currencies. The Council may, acting by a qualified majority on a recommendation from the ECB or from the Commission, and after consulting the ECB in an endeavor to reach a consensus consistent with the objective of price stability, adopt, adjust or abandon the central rates of the ECU [euro] within the exchange-rate system. The President of the Council shall inform the European Parliament of the adoption, adjustment or abandonment of the ECU [euro] central rate.
2. In the absence of an exchange-rate system in relation to one or more non-Community currencies as referred to in paragraph 1, the Council, acting by a qualified majority either on a recommendation from the Commission and after consulting the ECB or on a recommendation from the ECB, may formulate general orientations for exchange-rate policy in relation to these currencies. These general orientations shall be without prejudice to the primary objective of the ESCB to maintain price stability.
3. By way of derogation from Article 228, where agreements concerning monetary or foreign-exchange regime matters need to be negotiated by the Community with one or States or international organizations, the Council, acting by a qualified majority on a recommendation from the Commission and after consulting the ECB, shall decide the arrangements for the negotiation and for the conclusion of such agreements. These arrangements shall ensure that the Community expresses a single position. The Commission shall be fully associated with the negotiations.

Agreements concluded in accordance with this paragraph shall be binding on the institutions of the Community, on the ECB and on Member States.

4. Subject to paragraph 1, the Council shall, on a proposal from the Commission and after consulting the ECB, acting by a qualified majority decide on the position of the Community at international level as regards issues of particular relevance to

economic and monetary union and, acting unanimously, decide its representation in compliance with the allocation of powers laid down in Articles 103 and 105.

5. Without prejudice to Community competence and Community agreements as regards economic and monetary union, Member States may negotiate in international bodies and conclude international agreements.

NB: Language in brackets added for clarification.

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