

What can we conclude from this? Fiscal convergence itself is probably responsible for some of the current stagnation in Europe. This fiscal drag may worsen in the short run as several EU countries struggle with last-minute budget cuts to meet the 1997 deficit reduction criterion of 3% of GDP. Perhaps in the long run stronger private expenditure will result in renewed growth. A more deep-seated aspect of the problem is that we are beginning to see the results of a pan-European monetary policy which is suitable for some regions but not others - a situation which will be brought into sharper relief with EMU. Better then, that European monetary policy be formulated by a pan-European institution than by one major player. Another aspect is the underlying inflexibility of wages and labour markets, which as pointed out in the optimal currency discussion above, does not facilitate the functioning of an economy under monetary union.

3.2 The European Central Bank

The designers of the European Central Bank have been careful to make it as independent as possible from political and government influence. By statute, it will be prevented from seeking or receiving directions or instructions from governments. Furthermore, national governments are required to make their legislation compatible with that of the ECB. The model chosen is similar to that of the Bundesbank, which also has a federated structure, is quite independent and enjoys high credibility in financial markets.

Many countries have made or are making the required changes in central bank legislation, most notably the Banque de France, which has been made much more independent of government than it was. Interestingly, the Bank of England's legislation is not in compliance with the requirements for EMU, as the UK Treasury has the power to direct aspects of its operations. To date, there have been no plans to introduce changes, which would be needed before the UK can join EMU.

National currencies will continue to circulate after EMU begins. At the level of retail commerce and banking, the individual worker and shopper will probably not notice any difference; domestic currencies will continue to be used as means of payment, but they will merely be surrogates for the euro. The beginning of EMU will mark the establishment of one monetary policy and one set of interest rates across participating states - a "big bang" approach for financial markets. ECB operations in the interbank money market and the exchange market will begin immediately. Notes and coins, designs for which were unveiled at the Dublin Summit in December 1996, will be introduced by 2002.

3.3 EMU and European Competitiveness

EMU should result in relatively small medium to long run efficiency (productivity) gains for the European participants as foreign exchange transactions costs and the costs of