

European Economic and Monetary Union: Major Impact Likely on Canada

European Economic and Monetary Union (EMU) is likely to have major implications for Canada's role in international policy formation.

That will be all the more the case as the European Community (EC) speaks with a progressively more unified voice on matters of global economic concern.

This stronger European presence represents a challenge for Canada and will require a forceful and active Canadian presence in international financial institutions and fora, such as the G-7.

The economic impact of EMU on Canada is difficult to predict and depends on whether EMU results in an increase in international trade or merely increases trade within the EC. The overall macroeconomic impact is expected to be slight yet positive.

These are the conclusions of the interdepartmental *Europe 1992 Working Group Report on European Economic and Monetary Union* which was released at the January 15 "Europe in Transition" Conference in Toronto.

The European Monetary System and the Delors Plan

The European Monetary System (EMS) was created in order to establish greater exchange rate stability among Community currencies. It attempted to do so through three main instruments: a system of fixed, but adjustable, exchange rates, the Exchange Rate Mechanism (ERM); the European Currency Unit (ECU); and several credit facilities.

European Commission President Jacques Delors chaired a committee which has suggested a three-stage plan for modifying the EMS and moving towards monetary union. The goals of his plan are:

- the complete convertibility of all currencies;

- the complete liberalization of capital markets and the full integration of financial markets; and
- the irrevocable fixing of exchange rates.

The Delors Committee also suggested that, while not necessary, the adoption of a single European currency was desirable.

Delors has suggested three stages for achieving these goals:

- 1) The first stage, which began on July 1, 1990, involves the virtual elimination of capital controls in the Community, closer co-ordination of macroeconomic policies among member states, and the eventual participation of all member states in the ERM.

- 2) The second stage, scheduled to begin on January 1, 1994, involves the creation of a European System of Central Banks (ESCB).

- 3) The third stage, when exchange rates will be irrevocably fixed — its scheduled start date will be finalized before the end of 1996 — is dependent on the achievement of a sufficient degree of economic convergence among the twelve Community economies.

The detailed framework for the Delors plan is to be worked out by an Intergovernmental Conference which convened in December 1990 and is expected to last until at least the fall of 1991.

At the March 1990 meeting of EC Member State Finance Ministers and Central Bank Governors, it was agreed that the new ESCB should conduct monetary policy free from political control. No decision has been reached on the German and Dutch demand that national central banks also be independent of their governments.

Since the Intergovernmental Conference began, it has become clear that there exists some differences in opinion with respect to the desirability of EMU and the extent to which the ESCB will be

free of political influence.

Effects of EMU on the European Community

The economic impact of EMU on the EC should have two main influences:

Moving to a common currency should reduce uncertainty and transaction costs; this should have a beneficial effect on the level of income and welfare. The European Commission estimates that economies of scale to be made strictly in terms of reductions in costs of multi-currency handling are in the order of 15 billion ECU on intra-EC trade alone.

Assuming that the ESCB's commitment to price stability and fiscal discipline is maintained, economic gains should also flow from the pursuit of anti-inflationary monetary and fiscal policies and the associated increase in macroeconomic stability.

Balanced against these gains are the potential costs associated with more difficult adjustment of economic shocks. However, over the long run, the combination of EMU and the Single Market Initiative should promote easier adjustment, as factor mobility and the degree of economic integration improve.

Effects of EMU on Canada

To the extent that EMU leads to efficiency gains and higher output in Europe, international trade can be expected to increase. It is through the trade channel that the most important economic impact of EMU on Canada will be felt.

From Canada's standpoint as a consumer, increased efficiency in Europe could lead to lower import prices. On the other hand, the extent to which greater European integration encourages Europeans to prefer European suppliers and

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