The Implications of EMU for IMF Surveillance

Michael C. Deppler

How will EMU affect the way the IMF monitors economic developments in its European members?

THE THIRD and final stage of European Economic and Monetary Union (EMU) is set to begin on January 1, 1999, with the establishment of a currency union encompassing 11 of the European Union's 15 member countries—Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal, and Spain. On that date, these countries will lock their exchange rates; the euro, their common currency, will be born; and national authorities will hand over responsibility for monetary and exchange rate policies to area-wide institutions. With the economic size of the initial euro area rivaling that of the United States, EMU will represent an important milestone for both the European Union and the international monetary system.

EMU will have important implications for the IMF's work and procedures, including the IMF's "surveillance" activities—that is, its regular monitoring of economic policies and developments in member countries. The IMF has a mandate, under Article IV, Section 3 of its Articles of Agreement, to oversee the international monetary system and, to that end, to exercise firm surveillance over members' exchange rate policies. Regular consultations with members—known as Article IV consultations—represent the main vehicle for IMF surveillance. They are supplemented by periodic multilateral surveillance exercises, including those conducted in connection with the IMF's *World Economic Outlook,* which normally appears twice a year, and its annual *International Capital Markets* report. In addition, the IMF addresses issues from a regional perspective, whenever appropriate.

Although EMU represents a major change for the international monetary system, it has evolved gradually, giving the IMF time to adapt its practices. The IMF's Executive Board has met regularly to consider the EMU process as a whole, and EMU-related matters have become increasingly prominent in Article IV consultations with individual countries. Moreover, since the signing of the Maastricht Treaty in 1992, contacts between IMF staff and institutions in the European Union have multiplied as the latter has expanded its surveillance over the economic policies of its member states and the convergence criteria established by the treaty have played a growing role in policy formulation by national authorities. EMU issues have also featured prominently in the IMF's global surveillance exercises, including chapters on EMU in the editions of the *World Economic Outlook* published in October 1997 and October 1998.

Nonetheless, the advent of EMU will require further adaptation of the IMF's surveillance of euro area economies. Regular discussions with individual euro area members will remain a central element of IMF surveillance. But discussions with the European Central Bank (ECB), which began operations on June 1, 1998, will become a vital complement to the IMF's discussions with national authorities. The same would apply to the European Union's Council of Ministers should it exercise its prerogatives regarding matters pertaining to the exchange regime of the euro.

From an IMF surveillance perspective, the distinguishing feature of EMU is the transfer of monetary and exchange rate authority from 11 member states to supranational bodies even while authority for fiscal and structural policies remains vested largely in the national authorities. As a result, IMF surveillance will need to be conducted simultaneously at both the national and the supranational levels, keeping a weather eye on the implications both of the combined effect of nationally determined policies for area-wide monetary and exchange rate policies and, conversely, of area-wide monetary policy for national policy requirements.

Michael C. Deppler is Director of the IMF's European I Department.

In the context of the Article IV surveillance process, this means that discussions at the euro area level will focus on monetary and exchange rate policies, but against the backdrop of an evaluation of the combined fiscal and structural policies of the members of EMU, which is needed to assess the coherence of the overall macroeconomic policy mix. For instance, a given area-wide monetary policy and set of national fiscal policies might be judged to prompt an inopportune (from an international or euro area point of view) rise in real interest rates or appreciation in the real effective exchange rate. Depending on the circumstances, this might argue for an easier policy by the ECB or for an across-the-board or selective tightening of fiscal policies at the national level. The principal change in the content of consultations at the national level will be that discussions of monetary policy will focus on the impact of area-wide monetary policy on developments and policies at the national level, as well as on the implementation of monetary policy operations through the national central banks.

In addition to adapting its Article IV consultations to the advent of EMU, the IMF will continue its regular surveillance of economic policies in the European Union. It will pay particular attention to the surveillance carried out by EU institutions—notably by the Council of Ministers in the context of the Stability and Growth Pact, as well as in connection with the Council's broad economic policy guidelines and employment policy guidelines—and to policies affecting trade and the integration of EU markets.

The euro area faces a number of challenges ahead in ensuring that its new policy framework operates smoothly and in addressing the root causes of its high unemployment. The IMF is committed to discharging its surveillance responsibilities both to assist EMU participants and their common institutions in making EMU a success and, more generally, to help achieve the hopes and aspirations of the international community. F&D