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IMPLEMENTATION OF THE EURO: KEY CONSIDERATIONS FROM THE INTERNATIONAL BUSINESS PERSPECTIVE

Report on a meeting of management experts held under the OECD Labour/Management Programme

Paris, 5 November 1997

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OECD LABOUR/MANAGEMENT PROGRAMME

IMPLEMENTATION OF THE EURO: KEY CONSIDERATIONS FROM THE INTERNATIONAL BUSINESS PERSPECTIVE

Report on a meeting of management experts
held under the OECD Labour/Management Programme

(Paris, 5 November 1997)

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FOREWORD

Under the OECD Labour/Management Programme for 1997, a meeting of management experts on "Implementation of the Euro: Key Considerations from the International Business Perspective" was held in Paris on 5 November 1997. The meeting was prepared in collaboration with the Business and Industry Advisory Committee to the OECD (BIAC).

Below you will find the Agenda for this meeting, along with the Issues Paper and the overall report of the discussions of the meeting of experts, which were both prepared by Mr. A. Steven Englander, designated as General Rapporteur for this activity.

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AGENDA

1. Opening remarks

2. Financial Implications of EMU

a. Near term implications

- What will determine the exchange market response in the period just before and after EMU?
- How might bond markets respond?
- How might financial developments affect business in this period?

b. Longer term financial implications

- How will the Euro affect the competitive environment for financial service firms?
- How volatile will the Euro be against other major currencies?
- What will determine interest rate spreads between European economies?
- How will equity and bond markets evolve?
- How important will the Euro be as international currency?

c. Implications for non-financial activities

- How will the Euro affect real economic activity in the OECD? Over what time horizon?
- Will patterns of trade and fdi be affected?
- How prepared will firms be on day 1 of the Euro?
- To what extent will companies pursue a continental strategy following the introduction of the Euro?
- Will the Euro affect patterns of regional comparative advantage and regional specialisation and investment?

d. Potential benefits and risks

- What concrete benefits are envisaged from the Euro? Greater economies of scale, more rationale investment planning, greater transparency of financial accounts across countries and firms, reduced transaction costs, others?
- Over what time horizon will benefits for business emerge?

- Once the Euro uncertainty is settled, does business foresee an economic spurt and improvement in confidence?
- How high are the transition costs in legal, accounting, psychological terms?
- Do business foresee problems in coping with economic, political, or trade tensions emerging from the Euro?
- Will the Euro-zone look inward or outward economically?
- Are there likely to be particular tensions between the “Ins” and “Outs” in the early stages of EMU?
- If the Euro project fails either before or after a single currency is formed what will be the implications for business?

3. Summary of the results of the meeting by the rapporteur

DISCUSSION PAPER

by Mr. A. Steven Englander
International Economist
Smith Barney Inc.
(France)

1. SUMMARY

The birth of the Euro on 1 January 1999 is becoming an increasingly probable event. Its prospective positive contributions are lower exchange risks and capital costs in Europe, continued low inflation and progress on deficit reduction, and better investment efficiency in the long-term. The risks are that rigid labour and product markets will prevent adjustment when individual countries will have no discretion on monetary or exchange rate policy.

The biggest impact will be felt in the financial sector. In the short run, exchange rate volatility and trading volumes will drop between currencies to join the Euro. Decisions on who will join and at what parity will be announced in April/May 1998. In the long run, financial firms will face a much more competitive market in which home-field advantage would disappear.

2. FINANCIAL IMPLICATIONS OF EMU

a. Near term implications

Exchange rates and bond markets The single currency (the Euro) is scheduled to begin on 1 January 1999. EU central banks/finance ministries will indicate in April/May 1998 the final bilateral parities that they desire, so, if EMU is on course, the volatility in exchange markets between EMU participants will fall – and, of course, disappear once EMU begins, unless political risk remains. As long as EMU appears on course for a January 1999 start, the final bilateral parities indicated (but not fixed) in April/May 1998 are likely to provide strong guidance to market exchange rates till the Euro's debut in January 1999.

All prospective participants have stressed the importance of a strong and stable Euro, but financial markets have so far registered mixed expectations with respect to the advent of the Euro. Since the beginning of 1997, European currencies committed to joining the single currency have depreciated substantially versus the dollar. Many market analysts have associated a broad Euro with a weak Euro.

There is little evidence that bond markets are deeply troubled by the Euro. Core European 10-year government debt has consistently paid 70-100 basis points less than equivalent US debt over the last year. Spreads would be much less favourable to European bond yields if the bond market was discounting an inflationary surge or future weakness in European currencies.

Impacts on financial business The most immediate and direct impact on business will be a closing or narrowing of some financial markets in participating countries. Exchange transactions between currencies joining the Euro will be effectively eliminated at the wholesale level from January 1999 and will be totally eliminated with the issuance of Euro currency and coin in 2-3 years later. This reduction in transactions will be only partially offset by the creation of what is very likely to be a deep and liquid market for Euro instruments.

Net transactions levels are likely to fall in EMU member currencies. Some currency traders will be redundant unless they find other markets to trade. The most likely new candidates are developing economy currencies, especially those of eastern and central Europe, southeast Asia and Latin America. Volatility in exotic currencies, with trading levels that exceed what is justified by economic development, could well be a side effect of the single currency.

EU outsider currencies such as UK sterling, the Swedish krona, Danish krone, and even the Greek drachma will also see a reduction in volatility, if it looks likely that these currencies will participate in the relatively near future. To the extent that markets can look ahead to final bilateral parities for these currencies versus the Euro, there is a good chance that these parities will emerge relatively quickly. We are likely to see ‘convergence plays’ over 1998-99 that parallel what was observed over 1996-97 for the French franc, Spanish peseta and others.

Convergence has been beneficial to financial market participants who have generally bought into the convergence rally. It is likely that a second round of convergence rallies will be equally beneficial. Bond spreads will narrow to under 50 bp or less against benchmark rates in participating countries. In Canada spreads between provincial and federal public sector debt are less than 25 bp, other than for the provinces of Quebec and Newfoundland.

Impacts on non-financial business For non-financial business boring exchange markets represent a positive development. Even in the most Euro-sceptic countries, polls continually show businessmen to be in favour of a single currency.

No obvious monetary disequilibria are apparent among potential EMU entrants. Inflation rates have largely converged, and in level terms there are no big over- or under-valuations of currencies (the UK and Ireland aside). With inflation low and moderately contractionary fiscal policy in place, monetary policy can remain broadly expansionary for several years to come.

It should be noted that for Europe as a whole, interest rate convergence and exchange stability are broadly expansionary. Individual countries can gain temporarily from depreciations against other EU currencies that improve their competitiveness, but the EU region as a whole can not gain, except when the exchange rate moves restore equilibrium exchange rates following real or nominal shocks (and are not eroded by subsequent changes in domestic inflation)[1].

[1] A major source of exchange rate fluctuation among participating currencies, the deviation of monetary policy across countries, will be eliminated with the advent of the Euro. A second set of shocks that stem from portfolio flows, such as occur when exchange markets sell off on weak European currencies when the dollar depreciates, will also be eliminated. Where exchange rate flexibility would be useful is in changing real exchange rates when individual economies are hit by shocks that demand divergent interest/exchange rates, such as occurred after German unification. It remains an open empirical question in the European context as to whether the frequency of such shocks, their size, and the speed with which they are reversed (if ever) allow the gains from flexible exchange rates to exceed the losses.

The uncertainty and adjustment costs that emerge from large, even temporary, real exchange rate fluctuations may be unambiguously contractionary in their own right. Moreover, weak currency EU countries have typically had to pay up in real terms in money and bond markets, so the reduction in real interest rate risk premiums is an unambiguous growth bonus to the EU as a whole.

Risk in the outlook Deeply embedded structural problems in labour and product markets represent the biggest risk to the Euro project, as the real sector will have to buffer shocks that in the past could be mitigated by independent monetary policies and exchange rate moves. Output gaps still positive in the major Continental European economies and in most of the smaller ones, so monetary policy should be able to retain a sufficiently stimulatory stance in the near-term to offset the moderate ongoing fiscal consolidation envisioned by EU countries (and mandated by the Stability Pact).

Hence, the impact of structural problems will be masked in the near-term by a positive conjuncture, unless an unexpected negative shock occurs to hobble EU economies (or a subset thereof) in the coming few years.

Ultimately, some or all Euro economies will experience a downturn. If countries participating in the Euro do not take steps to enable their economies to respond more flexibly to changed economic conditions, adjustment that will fall entirely on labour and product markets will entail additional unemployment and tensions.

A second set of risks is from the political opposition to EMU that exists to some extent in all EU countries. The view that EMU should be delayed (or derailed) is very prominent in Germany, the anchor of the single currency, where there is a perception that a Euro with some weak currency links will inevitably be a weak Euro. At this point political rather than economic factors represent the biggest risk to EMU starting as scheduled.

b. Longer term financial implications

Financial firms The Euro will also give a boost to competition within European financial markets. At present local financial firms enjoy a significant ‘home team advantage’ when it comes to issuing securities denominated in their own currencies. The single currency is likely to flatten the playing field considerably as firms coming to the capital market for Euros will find that the currency dimension will be considerably simplified – putting a premium on old-fashioned price competition.

Returns from investments in other Euro-zone economies are likely to stabilise because of the disappearance of exchange risk and reduction of (and stabilisation in) spreads across fixed income instruments. By contrast, additional volatility in returns from extra-EU investments could emerge if the Euro/$ and other Euro exchange rates become more volatile because monetary policy becomes more ‘inward’ looking in the world’s major economic zone (see below).

Competition within Europe has also been inhibited by prudential limits placed on pension plans in the foreign currency risk to which they can be exposed. The single currency would eliminate many of the prudential hurdles to pension fund investment across borders within the Euro-zone.

Consumers will also benefit from the single currency. Certain types of consumer and mortgage debt instruments can readily cross borders within a single currency area. Competition for consumer deposits will also be intensified.

There will also be significant downsizing in the financial services industries. Pressures for mergers and downsizing will emerge at both the retail and institutional levels among providers of financial services. Many continental financial sectors are still over-staffed and over-branched as compared to their most vigorous competitors. The boost to competition from the single currency will accelerate a process that has lagged.

The Euro's volatility against other currencies The Euro-zone, especially when it expands to all 15 EU countries will be as larger or larger in population and economic size as the US or Japan. EU countries will trade less than 9% of GDP with non-EU countries (and even less as eastern Europe is absorbed[2].) European Central Bank policymakers will pay less attention to the Euro's value (whether rising or falling) against outside currencies because it has less of an effect on inflation. European inflation – and hence monetary policy – will be determined by domestic conditions.

Long-run strength of the Euro In looking at the fundamentals for the Euro-zone, whether composed of a narrow core, a broader group that includes Italy, Spain and Portugal, or all fifteen EU countries we find the following positives for the Euro:

- Inflation is below 2% in the EU and likely to stay lower than that of the US;
- Savings rates, especially household and national savings rates are significantly higher than that of the US across a broad range of real interest rates;
- Europe is running a considerable current account surplus that is unlikely to disappear with recovery while the US runs a substantial chronic deficit.

The big negatives for the Euro are high unemployment and public sector deficits. Fiscal deficits will average about 3-3 1/4% of GDP in 1997 and perhaps slightly lower in 1998, versus 1.5% or less in the US. However, Europe's high national savings rate and a large current account surplus means that the private sector has succeeded in more than offsetting the effect of public sector dissavings.

Some risk attaches to high/rising unemployment, which could lead to market doubts on the sustainability of fiscal and monetary virtue.

Rate spreads within Europe The elimination of exchange rate risk within the Euro-zone will narrow but not close completely interest rate spreads within participating financial markets. At short maturities, probably up to a year or so, there is virtually no risk attached to the treasury bills of participating countries and yields will be almost identical.

At longer maturities, spreads will narrow to those of the US municipal market or Canadian provincial bond market. However, some notional exchange risk will remain, especially during periods of elections and economic weakness, and be shifted onto the bond market until the European currency union is as well established as the US currency union, for example.

Liquidity could be very high in the Euro government bond market as the size would approach (and by some measures exceed) that of the US Treasury market. Even non-Euro investors will be attracted to the Euro for liquidity reasons.

[2] According to the EC non-EU exports as a share of GDP range from under five percent in Greece, Spain, and Portugal to over thirteen percent in Belgium/Luxembourg, Ireland, the Netherlands, Finland and Sweden.

To maximise liquidity, issuers will have to adopt common bond market conventions with respect to coupon frequency, yield calculations, etc., but agreement has not yet been reached on these issues.

Private sector bond and equity markets All firms of a given credit standing in Europe will be able to borrow based on the Euro benchmark interest rate, irrespective of the exchange rate history of their home countries. Some firms may be able to borrow at lower interest rates than their governments.

Equity markets will be greatly transformed and reorganised. The biggest firms will be traded on a cross-Europe screen trading basis. These large firms will be listed locally and in the large trading centres (London?, Frankfurt?). Trading is likely to ultimately be concentrated in the largest, most liquid markets. Liquidity in general will be enhanced by the removal of currency risk as a regulatory and substantive barrier to cross-border trading. Interacting with the trend toward the partial privatisation of public pension systems, some institutional funds are likely to be redirected out of local government bond markets into the EMU-wide equity market.

Investors and analysts are likely to shift to an industry, rather than country, focus. As with the bond market, a truly flat pan-Euro equity investment field is inhibited by the lack of a common accounting standard for firms, but such a standard is likely to emerge quickly as firms recognise the advantage of being truly transparent to investors on a continent-wide (and world-wide basis).

Greater liquidity in markets could especially help firms that are now just below the top tier in terms of liquidity and investor interest.

The Euro as an International Currency Our calculations suggest that EU countries are probably holding more dollar reserves than they will require under a single currency, with its much more limited currency and trade exposure than is now the case. While they are unlikely to dump their dollar excesses on the market in a fell swoop, EU governments and central banks could well be persistent net sellers of dollars in the future.

Reserves held in currencies entering EMU will become domestic currency (i.e. Euro) assets on the balance sheets of central banks. These are likely to be remitted to governments over time, preferably to reduce debt, but could also be used to finance once-off expenditures.

Once the Euro gets established, it is likely that investors and governments will seek to rebalance their reserve portfolios by adding Euros.

3. LONGER TERM NON-FINANCIAL IMPLICATIONS

Impact on Real Economic Activity The biggest potential benefits of the Euro are its impacts on investment decisions, competition and capital costs across the Euro-zone. These are difficult to quantify, however, and are likely to emerge only over a long period of time.

The single currency will probably enhance competition in non-financial as well as financial sectors. Such competition is also likely to encourage structural reform and greater flexibility of labour markets, which will enhance both microeconomic and macroeconomic performance.

If restructurings occur during a period of slow growth, then structural weaknesses in labour markets will be more evident as newly unemployed remain inactive for long periods, as has been the pattern in past years in Europe.

How Prepared Will Firms Be on Day 1 of Euro? Financial firms have to deal most directly with the Euro. Preparations among major firms in major financial centres appear well under way. The problem is most acute for financial firms because they will have massive retail dealings with the public in national currencies after 1999 and possibly till 2002, but wholesale financial transactions will be in Euros right from the start.

The computing system problems are sufficiently serious that large European financial firms are recruiting US software and systems people to help set up computer systems for the new currency. There is a risk that smaller firms without access to the international computing market will be left behind or have to pay a high price for adjustments.

Non-financial firms have the option of retaining accounts in national currencies until national money's disappear entirely in 2001/2002. Large international firms are likely to move first as investors would prefer to see accounts in Euros. Smaller firms are likely to remain in local currencies for a time and depend on their banks to handle Euro conversions.

Regional comparative advantage and specialisation Taken together the single market for goods and services combined with the single currency would remove virtually all impediments to optimally siting plants and firms. The process of concentration will be more readily visible in emerging industries, where history and past investment are less constraining, however.

Transition costs The Euro will encourage the establishment of a common legal and accounting framework, a positive long-run step, but carrying transitional costs.

Small business and the retail sector in particular have the most genuine cause for complaint and worry, as items will be priced both in Euros and in local currencies during the shift from national currencies to the Euro.

The Euro as a source of economic, political and trade tensions There are differences among EU governments in the desired degree of government intervention in macroeconomic and microeconomic activities; these could become sharper under the single currency. The Buba's popularity and reputation have made the German government more reluctant to attempt interventions on monetary and exchange policies than in other EU countries.

Expansion of the Euro-zone beyond the EU15 will cause particular tensions. There is likely to be considerable debate as to when the future central and eastern European members of the EU should join the Euro.

The Euro should not have a first-order impact on trade relations within the Euro-zone or outside. However, with the elimination of currency depreciation as a way of restoring competitiveness, any overvaluation that comes from domestic inflation differentials will be eliminated only with difficulty. Countries which become expensive relative to EMU partners are likely to focus on regulatory, tax and other microeconomic dimensions as sources of competitive disadvantage.

As discussed above, the Euro could become more volatile against the dollar than the weighted sum of European currencies that it replaces. Internationally traded commodities could find themselves swinging more violently from profitability to non-profitability.

The Euro-zone facing inward or outward Other than its eastward expansion and perhaps some closer economic ties with north African countries the Euro-zone will primarily face inward. The process of adaptation to the single currency and decisions on what microeconomic/structural regime to adopt will preoccupy policymakers for some time to come.

Failure of the Euro project A more taboo subject than incest in European policy circles. We are optimistic that the Euro project will go ahead as planned in January 1999 and will ultimately succeed, but business ought to be aware of the implications of failure, since success is not guaranteed.

If the single currency falls apart before January 1999, business faces some write-offs in terms of its investment in preparing for the Euro, but the resultant uncertainty about Europe's ultimate exchange rate regime could hamper growth.

Partial or complete dissolution of the single currency after its formation will leave both EU and non-EU financial markets in chaos. It will not be clear how debts contracted in Euros will be settled. This uncertainty would prove more debilitating to business than any of the macroeconomic risks hitherto discussed.

FINAL REPORT ON THE MEETING

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1. MACROECONOMIC ISSUES

Monetary policy issues. Participants viewed the advent of the Euro as carrying potential advantages and disadvantages. A strong European Central Bank would be a clear advantage for economies whose monetary policy had suffered from a lack of credibility in the past. Moreover, core European economies have already been following an effectively coordinated monetary policy for a number of years, so the formal transition to the Euro will not mark a major shift in monetary policy.

Participants recognised as well the risk that a common currency and monetary policy might not be suited to all countries at all times. Economic shocks to individual countries would have to be dealt with by structural flexibility in labour and product markets and fiscal policy. Some participants expressed reservations on the likely adequacy of such mechanisms. On the other hand, without the Euro there was a perceived risk that competitive devaluations down the road could ultimately destroy the common market. Hedging against currency fluctuations was expensive and exchange rate overshooting had often proved expensive for SMEs.

With the exception of the Irish punt current exchange rates between likely EMU participants did not look way out of line [and the punt has moved much closer to its ERM mid-point since the meeting]. UK sterling also appears substantially overvalued, but its outsider status for the first round of EMU meant that no decisions on the final parity would have to be made in the near term. It was stressed that enlargement of the EU to the east did not necessarily mean that the new members' currencies would immediately participate in the Euro. Indeed, it was suggested that new entrants to the EU should not immediately try and hit the Maastricht convergence criteria. However, the new EU members themselves might push for early EMU participation.

Fiscal issues. There was broad support for the need to maintain tight fiscal policy and recognition of the need to create institutions to enforce fiscal stability. Some participants expressed concern that the Growth and Stability Pact to limit deficits to 3% of GDP would be a 'strait-jacket' in times of asymmetric shocks or broad economic downturns. But it was noted that fiscal policies have been pro-cyclical in the past, so the stability pact would contribute a useful stabilisation function.

Nevertheless, there was a risk that the stability pact itself would produce pro-cyclical fiscal impulses, unless budgets were close to balance at business cycle peaks. While several smaller countries looked likely to achieve that goal, the larger EU countries were not likely to be close in 1998 or 1999.

Some concern also emerged that the accounting methods used by EU countries in trying to hit and stay below the 3% of GDP deficit target would be too aggressive and call into question the credibility of EU deficit accounting. The policy responses to deviations from the deficit criteria would also affect the credibility of the single currency.

Exchange rates. Panel members were divided about whether the Euro would bring more or less exchange rate volatility. On the side of greater volatility was the risk that a highly liquid currency without a track record would be subject to waves of speculative buying and selling, while the central bank would be preoccupied with domestic inflation.

The argument for a stable currency were the sound fundamentals that the Euro was starting with, the mandate of the ECB to maintain low inflation and the commitment of member countries to maintain sound monetary and fiscal policies. A stable Euro exchange rate was viewed as desirable against major currencies, but there was little advocacy for either attempting to set the Euros level high or low for strategic reasons. Panel members noted comments from European Commission members that indicated a preference for a strong Euro that challenged the dollar as a reserve currency.

The role of structural policy. Several participants worried about whether labour market flexibility was sufficient to buffer country-specific shocks without the safety valve of independent monetary policy and subject to substantial fiscal constraints. In particular, the advent of EMU would entail structural changes to product markets stemming from intensified competition and productivity gains that would have a counterpart in displacement of workers. Concerns were raised as to whether the labour market mechanism in place was sufficient to find alternative employment for these displaced workers. Several pannellists thought that EMU could be deflationary because the positive productivity effects would outweigh any increase in labour demand.

Limited labour market mobility and intensified regional divergence were also concerns. The Australian move to a 38-hour workweek, which is finding echoes in current EU labour market discussions, was cited as having had a negative impact on Australia's competitiveness.

It was noted however that the European tradable goods industries had shown themselves to be more flexible than the economies at large, so that their buffering capabilities could be stronger than expected.

2. STRUCTURAL ISSUES

Impact on competition. The single currency will automatically lead to pricing in Euros. Despite the theoretical ease in translating from one European currency to another at present, the panel argued that being able to compare prices across borders in a common currency will lead to a big gain in pricing transparency, and a step jump in price competition among firms. The increase in price competition will drive productivity gains in price sensitive sectors and lead to consolidation in these sectors. Panellists agreed that the Euro would contribute to levelling the playing field in both financial and non-financial business.

The Euro would promote competition in the financial services industries, but there would be a spillover of increased competition to other services industries as well, which previously had been relatively closed. The single currency was viewed as the last step in completing the single market for goods and services. As such, its impact was intertwined with that of other competition-increasing policies.

There was a general sentiment that the Euro could serve as a catalyst to promote more vigorous competition and pan-European strategies among firms.

Strategic implications of the Euro. There was a perception that the Euro will require a big strategic change on the part of firms, with increased focus on pan-European strategies. This would be a gradual process over several years. The increase in price competition in price sensitive sectors will lead to a strategic focus on high value-added industries with high product differentiation and relatively low price sensitivity.

A benefit of the Euro would be improved quality of investment. Several panellists mentioned that too much investment in the past had been defensive in nature and motivated at least in part by exchange rate worries rather than real competitive concerns.

Financial sector. The single market would bring first order changes to the financial sector. Panel members felt that there would be significant advantages to non-financial firms from a single capital market for equity and debt.

Institutional investing was expected to undergo a big transformation. At present, investable funds were often bottled up inside their own countries because of currency matching requirements or other reasons. The removal of currency risk within the Euro-zone would encourage more cross-border investing and would promote further an already ongoing shift from bank to capital market-based financing.

Europe's banks are likely to face a period of slow asset growth and consolidation. There is likely to emerge aggressive competition in retail banking. As well, there will be fierce competition among financial centres to gain the lion's share of Euro-denominated exchange, equity and fixed income trading. Although London currently appeared to hold an advantage, it was not clear whether one centre or multiple financial centres would emerge.

Bond markets and risk premia. Among Euro participants risk premia were seen as narrowing in ordinary times. Spreads of long-term government bonds were likely to narrow to substantially less than 50 basis points. There remained a risk that these spreads could balloon if budget deficits expanded. In the private bond market, greater emphasis was likely to fall on credit analysis as currency risk receded in importance.

The Euro government bond market was likely to remain less homogeneous than the U.S. or Japanese government bond markets. Recommendations on market conventions have been issued but these remain to be clarified and it was not obligatory to adhere to these conventions.

Accounting. Down the road, it was expected that the common currency would lead to pressures for a common European accounting standard and possibly for a common canon of business law. These moves would be driven from below by business and investor demand, however, rather than by EC initiative.

3. TRANSITION ISSUES

Level of preparedness. On the whole preparedness for the beginning of the Euro appeared to be at a relatively low level among business. About 75% of large businesses were taking active measures to prepare for the Euro, while about 12% of small and medium sized businesses were preparing actively. It

was not clear whether there should be more concern about the 25% of large businesses that had not started active preparations versus the 88% of SMEs that had not.

Big businesses will almost certainly have to be able to deal in Euros with customers and suppliers from the start. Small businesses might be able to rely on their banks to do their translations into Euros as needed, while they remained in local currencies. Any firm that either already transacts across EU borders or wishes to would require the capability to deal in Euros. It was noted that the Euro would represent an enormous simplification for small firms that already transact across EU borders and who wish to transact across borders.

Other issues. Even if they were not planning to fully convert to Euros in the near term, it was thought important that small and medium sized firms be aware of the implications of the Euro for their business. Among the issues that could affect firms were tax implications, continuity of contracts from current contracts into Euros, cash handling procedures in the dual currency period, staff training, and wage negotiations when currency depreciation against major trading partners becomes impossible.

Retail sector. Although conversion to Euro notes and coins is still several years away, the retail sector posed a number of specific problems. Opinions varied on how expensive and inconvenient it would be to have dual pricing at the retail level for a period of transition. However, it was generally agreed that dual pricing sheets at the cash register would not be overly onerous on storekeepers. For small items it was felt that the conversion from convenient price points in local currency into Euros could create confusion.

Practical steps for Euro implementation. A representative of a multinational computer/computing services firm discussed his company’s preparations. Projects include: providing services to companies on how to prepare for the Euro; assessing market needs in respect to Euro products; determining the hardware and software products that will be needed with the Euro; managing internal and external communications on the Euro; assessing differential Euro-related needs in different countries.

Costs of implementation. The panel recognised that all estimates of Euro conversion costs had a large margin of errors. A rough estimate was that over six years Euro conversion would cost about $150 bln on information technology and $250 bln in all. Over the six years this would present an annual cost of about 0.3% of GDP on IT and 0.5% of GDP overall. A computer expert on the panel thought that converting to the Euro could be about 20% more expensive than dealing with the millennium problem. While such costs are high in absolute terms, they were viewed as once-off and small relative to the potential benefits.

There were indications of wage escalation in the information technology sector and it was thought that demand for computing skills would almost certainly exceed supplies in coming years.

Accounting. Some panellists indicated that their firms would shift to accounting in Euros right beginning in 1999, whether or not their own country would be in EMU or not. A survey was cited that indicated that 7 out of the 20 largest Swedish firms intended to shift to the Euro quickly. Advantages included greater transparency to investors, economies of scale in introducing computer systems that dealt with the Euro and millennium problems simultaneously and economies in corporate treasury operations.

Others saw a less pressing need for an immediate switch into Euro accounting, although the capacity would be in place to purchase supplies, deal with clients, invoice and be invoiced in Euros. The need to deal directly with immediate consequences of the Euro and the impending millennium problem would put too severe a strain on available IT resources. A window of opportunity could open sometime after 2000,

when presumably the millennium problem would have been dealt with, but before the final 2002 retail conversion to the Euro, when pressures on IT resources would be somewhat mitigated.

To some extent the appropriate strategy depends on the market. If investors develop a quick preference for accounts denominated in Euros, competitive pressures could force early accounting moves, irrespective of pressures on IT resources.

4. PUBLIC POLICY ISSUES

Policies. The public sector was viewed as having a crucial role to play in the transition to the Euro. Governments and the European Commission were expected to establish clear rules of the game with respect to dealing with Euros. It was though important that fiscal authorities allow tax, custom and excise payments to be made in Euros or domestic currencies during the 1999-2002 transition period. Audit trails and accounting records, where required by the authorities, should be permitted in Euros or domestic currencies.

Efforts should be made to avoid unfavourable fiscal effects from the switchover to the Euro. In particular, some distortions could arise if firms in formerly high inflation countries switch their accounts into Euros and restate the book value of their assets closer to their current values.

Participants from several countries expressed concern that EU governments had not yet made definitive engagements on many of these issues. The quality of the implementation at the national level, as well as at the EU level, was viewed as crucial to the success of the transition.

Some disappointment was expressed at the slowness of structural change in Europe. Governments were seen as lagging in liberalising their labour and product markets. Inflexibility was viewed as a major stumbling block to the success of the Euro. Participants were also concerned that moves to tax harmonisation following the advent of the Euro should not push up the overall level of taxation or prevent healthy tax competition.

ANNEX -- LIST OF PARTICIPANTS

MANAGEMENT EXPERTS

Name	Position / Organisation	Country
Dr. Steven Kates	Chief Economist Australian Chamber of Commerce and Industry (ACCI)	AUSTRALIA
Dr. Gerhard Pschor	Federation of Austrian Industry	AUSTRIA
Mr. Erkki Hellsten	Director in charge of Economic Affairs Confederation of Finnish Industry and Employers	FINLAND
Mr. Peter Cruttenden	Director of Process Management IBM Europe	FRANCE
Mr. Ulrich Hofmann	Chief Economist IBM Europe, Middle East and Africa	GERMANY
Dr. Andrea Gavosto	Senior Vice President Chief Economist FIAT S.p.A. - Studi Economici	ITALY
Mr. Kazuteru Tanaka	Vice-Chairman of the BIAC Economic Policy Committee Economic Advisor to the President The Bank of Tokyo-Mitsubishi	JAPAN
Dr. Emil Ems	Federation of Swedish Industries	SWEDEN
Mr. Sudhir N. Junankar	Associate Director Economic Analysis Confederation of British Industries	UNITED KINGDOM
Mr. Philip L. Swan	**Chairman of the meeting** Director of Economics IBM Corporation	UNITED STATES
Mr. Stephen Canner	Vice President, Investment Policy U.S. Council for International Business	UNITED STATES

BUSINESS AND INDUSTRY ADVISORY COMMITTEE TO THE OECD (BIAC)

Mr. Steven L. Bate	Executive Director	
Mr. Denizhan Eröcal	Manager	

RAPPORTEUR

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OBSERVERS

Mr. Stefan Huemer	Attaché Permanent Delegation to the OECD	AUSTRIA
Mr. Luc Rifflet	Counsellor Permanent Delegation to the OECD	BELGIUM
Mr. Pavel Klima	Counsellor Permanent Delegation to the OECD	CZECH REPUBLIC
Mr. Dimitris Andreou	First Secretary Permanent Delegation to the OECD	GREECE
Mr. Jong Yul Yoo	Chief Manager International Relations Office The Bank of Korea	KOREA
Mr. Leszek Bartoszuk	Ministry of Finance	POLAND
Mr. Peter Puentener	First Secretary Permanent Delegation to the OECD	SWITZERLAND
Ms. Nermin Karakaya	Counsellor Permanent Delegation to the OECD	TURKEY
Mr. Georges Lemonidis	Counsellor Permanent Delegation to the OECD	EC

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Economics Department

Mr. Jorgen Elmeskov	Counsellor for Structural Policy
Mr. Mike Kennedy	Head of the Money and Finance Division
Ms. Flavia Terribile	Administrator Money and Finance Division

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Mr. John Thompson	Head of the Financial Markets Division

Directorate for Science, Technology and Industry

Mr. Risaburo Nezu	Director

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Mr. François Rousseau	Deputy Head of the External Relations Division