Gains from euro adoption are not automatic

(Continued from front page) eliminating market risks, Köhler said. A forthcoming study by IMF staff suggests that, over the long term, euro adoption could raise GDP by as much as 20–25 percent in most Central European countries.

But these gains are not automatic, according to Köhler. The loss of the monetary policy instrument after euro adoption will shift the burden of adjustment to other channels, notably fiscal policy and wage and price flexibility. Western Europe's own experience of the 1990s showed that while in some countries euro adoption served as an incentive for economic reform and adjustment, in others—especially the larger countries—it did less so.

Early and ambitious fiscal adjustment will help accession countries protect themselves against destabilizing capital flows in the run-up to adopting the euro. In some cases, he said, this adjustment ought to go beyond the requirements of the Maastricht criteria for deficits (below 3 percent of GDP) and public debt (less than 60 percent of GDP). Moreover, financial market supervisory agencies need to be acutely aware of the risks to domestic financial stability stemming from the rapid credit growth that is likely to accompany euro adoption. ■

New members and the Maastricht criteria

Four conditions—described in the Maastricht Treaty, which sets out the legal principles for Europe's Economic and Monetary Union—must be met before countries can adopt the euro. The conditions, which must be assessed at a single point in time are

• annual average inflation rate that does not exceed that of the three best performing member states by more than 1½ percentage points;

• annual average nominal interest rate on the 10-year benchmark government bond that is no more than 2 percentage points above the corresponding average in the same three countries;

• a fiscal deficit below 3 percent of GDP and public debt less than 60 percent of GDP; and

• trading of the country's currency against the euro without severe tensions within "the normal fluctuation margins" of the Exchange Rate Mechanism (ERM2) for at least two years.

The full text of the Managing Director's speech is available on the IMF's website (*www.imf.org*).

Growth, dollar top Group of Seven agenda

German Finance Minister Hans Eichel (left), Japanese Finance Minister Sadakazu Tanigaki, IMF Managing Director Horst Köhler, and World Bank President James Wolfensohn at the February 2004 Group of Seven meeting in Boca Raton, Florida.

Meeting amid media and market attention to the weak dollar, the finance ministers and central bank governors of the seven major industrial countries (Group of Seven) on February 7 reaffirmed their belief that exchange rates should reflect economic fundamentals, adding that "excess volatility and disorderly movements in exchange rates are undesirable for economic growth." They also emphasized that "more flexibility in exchange rates is desirable for major countries or economic areas that lack such flexibility to promote smooth and widespread adjustments in the international financial system, based on market mechanisms."

While the dollar took center stage in media attention, the statement issued at the end of the weekend-long meeting in Boca Raton, Florida, indicated that a wide range of issues was discussed. The representatives were upbeat about global growth prospects for 2004 but remained concerned about the uneven pace of growth in the seven countries. Supply-side structural policies that enhance flexibility, they reiterated, hold the key to higher productivity growth and increased employment.

The importance of combating terrorism and boosting economic growth in the Middle East also featured prominently in the discussions. The IMF and the World Bank were called upon to "make permanent and comprehensive their assessments of countries' efforts to combat terrorism financing," and the group expressed its commitment to further enhancing transparency and supervisory standards in financial markets, particularly in noncompliant offshore centers (see related story on page 38).

The finance ministers and central bank governors welcomed steps taken on the monetary front in Iraq, progress on the reform and reconstruction efforts in Afghanistan, and IMF and World Bank plans to provide both countries with financial and technical assistance. The group also urged other countries to join in efforts to reduce the debt burdens of Iraq and Afghanistan.

Finally, in a discussion of reforms of the international financial system, the meeting reviewed progress on "improved surveillance, collective action clauses, limits on exceptional access, measuring results, and the use of other mechanisms, including grants, to avoid heavy debt burdens." The ministers and central bank governors also called on Argentina to "implement policies in line with its IMF program" and to "engage constructively with its creditors to achieve a high participation rate in its restructuring."