

MONETARY AND EXCHANGE RATE ARRANGEMENTS OF THE EURO AREA WITH SELECTED THIRD COUNTRIES AND TERRITORIES



Since its inception, the euro area has established close monetary and exchange rate relations with a number of third countries and territories. In Europe, although they are not members of the European Union, Monaco, San Marino and the Vatican City use the euro as their official currency and even issue their own euro coins. Outside Europe, the euro is used in the two French overseas territories of Mayotte and Saint-Pierre-and-Miquelon, which also do not form part of the European Union. The use of the euro in these countries and territories is not a case of “unilateral euroisation” but takes place with the official approval of the European Community. In addition, a number of countries and territories that share a history of close economic and political ties with a euro area country, namely French Polynesia, New Caledonia, Wallis and Futuna Islands, Cape Verde, the Comoros and the countries of the CFA¹ franc zone, have pegged their currencies to the euro with the official approval of the European Community.

This article, which is mainly of a descriptive nature, provides an overview of the existing monetary and exchange rate arrangements of the euro area.² After briefly recalling the rationale for establishing such arrangements, and their legal basis, the article gives short descriptions of the various arrangements with a view to providing greater information about the cases where the euro is officially used outside the Community or where it serves as a fixed peg for third currencies. Possible future monetary and exchange rate arrangements involving the euro area are also discussed.

I INTRODUCTION

The Treaty establishing the European Community (hereinafter “the Treaty”) explicitly provides for the conclusion of monetary and exchange rate agreements with third countries and international organisations. Article 111 of the Treaty distinguishes between three different forms of arrangements. First, in accordance with Article 111(1) of the Treaty, the Community may, under certain conditions and following special procedures, conclude formal agreements on exchange rate systems for the euro in relation to non-Community currencies. One such example was the “Bretton Woods” system of fixed, but adjustable, exchange rates. Second, in the absence of such an exchange rate system, the Community may, under Article 111(2) of the Treaty, formulate “general orientations” for the euro area’s exchange rate policy in relation to non-Community currencies. Third, Article 111(3) of the Treaty establishes that the Community can conclude agreements concerning monetary and exchange rate matters with one or more states or international organisations. The involvement of the ECB in each of the possible Community actions is explicitly ensured under Article 111 of the Treaty.

The scope of exchange rate agreements under Article 111(3) of the Treaty covers, by way of exclusion, all cases not covered by Articles 111(1) and 111(2) of the Treaty. In this context, it should be mentioned, for the sake of clarity, that the Community’s Exchange Rate Mechanism II (ERM II) does not fall under any of the options covered by Article 111 of the Treaty. The mechanism deals with the exchange rate relations between the euro and other Community currencies and not with non-Community currencies, which are exclusively the subject of Article 111 of the Treaty.

To date, the Community has only made use of the third type of arrangement³, i.e. as covered

1 CFA stands for Communauté Financière Africaine.

2 This article does not consider cases of “unilateral official euroisation”. In these cases, the decision to attribute to the euro – or to one of the preceding legacy currencies before 1999 – the status of official legal tender has been taken without any involvement of the European Union. The two cases of unilateral official euroisation are the Republic of Montenegro and Kosovo.

3 The term “arrangement”, as used in this article, covers both bilateral agreements and unilateral decisions taken by the Council.

by Article 111(3) of the Treaty.⁴ This article addresses the monetary and exchange rate arrangements established under this provision and is structured as follows. Part 2 briefly recalls the rationale for the conclusion of monetary and exchange rate arrangements. The Community's legal basis for the conclusion of such arrangements is described in Part 3. A more detailed overview of the various arrangements in place is provided in Part 4, which also examines possible future monetary and exchange rate arrangements involving the euro area.

2 THE RATIONALE FOR MONETARY AND EXCHANGE RATE ARRANGEMENTS WITH SELECTED THIRD COUNTRIES AND TERRITORIES

All the countries and territories that are currently involved in monetary arrangements with the European Community had one immediate motivation for introducing the euro, namely that they were using a legacy currency of the euro as their official currency prior to its introduction.⁵ Previously, Monaco, Mayotte and Saint-Pierre-and-Miquelon used the French franc as their official currency, while San Marino and the Vatican City used the Italian lira. The most straightforward solution for the disappearance of these national currencies was to replace them with their successor currency, the euro, thereby ensuring the continuity of existing links between the third countries and territories concerned and the European Community.

The fact that these countries and territories were using a legacy currency of course had a broader background. The common element in this was a history of close economic and political ties between each of these countries and the anchor country. In the cases of Monaco, San Marino and the Vatican City, their geographical situation and size were a major factor in the development of such ties.

With regard to the advantages of introducing the euro by mutual agreement with the European Community, one major tangible benefit is the elimination of transaction costs associated with the exchange of the currencies involved. This benefit will be greater for small open economies, as a larger share of all transactions conducted by their residents is with non-residents. Among the other benefits – often mentioned in economic literature – of introducing another country's currency are the positive effects on macro-economic stability, risk premia for borrowers, the development of the domestic financial sector and international economic and financial integration.

The main reason behind the exchange rate arrangements discussed in this article was the continuation of existing relations. More generally, the advantage of fixed exchange rate pegs for the pegging countries is seen in the contribution they can make to economic stability. In the cases described, it is not so much the fixed exchange rate, but rather the substantial fiscal transfers made by the guaranteeing country and needed to finance the current account deficits of the beneficiary country, which provide for such stability. Furthermore, a stable exchange rate is generally conducive to economic and financial integration with the anchor country/currency area.

The introduction of the euro in third countries and territories and guaranteed currency pegs may also have a number of potential benefits for the euro area. The introduction of the euro outside the Community will result in an increase in seigniorage revenues. In the cases under discussion, this benefit can, however, be assumed to be very small, owing to the small

4 Formally, monetary and exchange rate arrangements involving the euro are concluded or established by the European Community. Any decisions to this end are, however, exclusively taken by those EU Member States that have adopted the euro. Against this background, the described arrangements are referred to as arrangements of the euro area.

5 The term "legacy currency" refers to the former currencies of the EU Member States that have been replaced by the euro.

size of the economies and the fact that Monaco, San Marino and the Vatican City are allowed to issue certain amounts of their own euro coins (see below). Furthermore, the agreements with third countries may also be used to ensure their cooperation in areas of interest to the euro area, such as the fight against counterfeiting, money laundering, tax evasion, and banking supervision and regulation. Finally, the introduction of the euro in third countries and territories can serve as a means for the Community to confirm and further strengthen economic, financial and historic ties with third countries and territories.

While monetary and exchange rate arrangements are motivated by their potential benefits, it should be noted that their conclusion is not without cost or risk. The obligation of third countries to ensure the applicability of relevant EU legislation, for example, obviously involves costs. In addition, sacrificing the possibility to adjust their exchange rate may also be seen as a cost to third countries that have introduced the euro.⁶

3 THE LEGAL FRAMEWORK

As explained above, the scope of application of Articles 111(1) and 111(2) of the Treaty covering exchange rate systems and general orientations for the euro area's exchange rate policy is rather clear-cut. However, the same cannot be said of Article 111(3) of the Treaty, especially regarding the conclusion of monetary agreements. Consequently, the fundamental question emerges as to whether the Treaty provides for a legal basis for the conclusion of such agreements. Indeed, while the Treaty foresees the single currency as the currency of the European Community (implying within its boundaries), it does not mention the currency's introduction outside the Community. In the meantime, however, a consensus has emerged whereby the expression "agreements concerning monetary [...] matters", used in Article 111(3), would also cover the introduction of the euro outside the Community's boundaries.

Accordingly, Article 111(3) has now become the generally accepted legal basis for the introduction of the euro outside the Community. To date, Article 111(3) has only been invoked for the conclusion of monetary agreements with countries that were using a legacy currency before its substitution by the euro.

Notwithstanding the above, and reflecting the initial uncertainty surrounding the appropriate legal basis, the euro was introduced in the French overseas territories of Mayotte and Saint-Pierre-and-Miquelon on 1 January 1999 (at the same time as it was introduced in the Community) pursuant to Article 123(4), which allows the Council to take measures "for the rapid introduction of the euro".⁷

The scope of monetary agreements with third countries and territories may go far beyond the mere use of the euro as an official currency. Monetary agreements deal with a number of related matters, such as the fight against counterfeiting and issues falling within the competence of the Eurosystem, for example monetary policy operations, payments system issues and banknotes.

As for exchange rate arrangements on the basis of Article 111(3), their scope, as explained above, is best described by way of exclusion. Consequently, they cover all matters that are not covered by Articles 111(1) and 111(2) of the Treaty. Until now, the most pertinent cases have been arrangements concerning the pegging of third currencies to the euro.

With regard to the conclusion of monetary and exchange rate agreements, Article 111(3) of the Treaty lays down a procedure that involves the

6 A broader overview of the potential costs and risks associated with the conclusion of monetary and exchange rate arrangements is provided in the following Monthly Bulletin articles: "Exchange rate regimes for emerging market economies" (February 2003 issue) and "The international role of the euro: main developments since the inception of Stage Three of Economic and Monetary Union" (November 2003 issue).

7 Council Decision 1999/95/EC of 31 December 1998 concerning the monetary arrangements in Saint-Pierre-and-Miquelon and Mayotte; OJ L 30, 4.2.1999, p. 29.

Council, the Commission and the ECB. In practical terms, this procedure can be broken down into three stages. In the initial stage, the Council, based on a recommendation from the European Commission and after consulting the ECB, sets out the mandate for the negotiation and conclusion of such agreements. The second stage consists of the negotiations themselves, leading to a draft agreement covering all issues included in the mandate. Besides the European Commission, which by law is required to be fully associated with the negotiations, the ECB also participates. Finally, the Council concludes the agreement (whereby the Council can mandate a Member State to act on its behalf).

Deviating from the procedure pertaining to the conclusion of bilateral monetary and exchange rate agreements, Article 111(3) of the Treaty also allows for unilateral decisions by the Council concerning the monetary and exchange rate relations of the euro area vis-à-vis third countries. The ECB is also consulted by the Council prior to such decisions being taken.

4 EXISTING MONETARY AND EXCHANGE RATE ARRANGEMENTS

The European Community's existing monetary and exchange rate arrangements are described below. The first section refers to the agreements concluded with Monaco, San Marino and the Vatican City, as independent European countries, to replace a legacy currency with the euro. Reference is also made to ongoing negotiations with Andorra. The following section describes the arrangements concerning the introduction of the euro in the French territories of Mayotte and Saint-Pierre-and-Miquelon, which are part of France but not of the European Community. Additionally, some clarification is provided on the use of the euro in the French overseas departments, which are an integral part of the euro area. The third section deals with the existing exchange rate pegs between the euro and the Cape Verde

escudo, the CFA franc and the Comorian franc. The exchange rate peg between the euro and the CFP franc, which is used in French Polynesia, New Caledonia and Dependencies and Wallis and Futuna Islands, is discussed in the fourth section, given its specific legal basis.⁸ Finally, the fifth section provides an overview of potential future cases of monetary and exchange rate arrangements were Denmark and the United Kingdom to join the euro area. These concern Greenland and the Faroe Islands, which are autonomous regions within the Kingdom of Denmark, and the Channel Islands (Jersey and Guernsey), the Isle of Man, Gibraltar, the Falkland Islands and Saint Helena and Dependencies, all of which maintain special relations with the United Kingdom.

4.1 THE MONETARY AGREEMENTS WITH MONACO, SAN MARINO AND THE VATICAN CITY, AND NEGOTIATIONS WITH ANDORRA

Following the introduction of the euro in 1999, the European Community initiated the renegotiation of existing arrangements with Monaco, San Marino and the Vatican City. Until end-2001, the French franc was used in Monaco on the basis of a monetary agreement with France, while in San Marino and the Vatican City the Italian lira was the official currency on the basis of agreements with Italy. In Declaration No. 6 attached to the Treaty, the Community made a commitment to renegotiate these agreements in view of the introduction of the euro. On behalf of the Community, France negotiated with Monaco, while Italy took care of the negotiations with San Marino and the Vatican City. The ECB also participated in these negotiations on issues falling within its field of competence. At the end of 2000, agreements were concluded with San Marino and the Vatican City, and in 2001, just before the introduction of the euro banknotes and coins, an agreement

⁸ CFP stands for Change Franc Pacifique.

Table 1 Maximum annual amount of euro coins that Monaco, San Marino and the Vatican City are currently allowed to issue

Monaco	San Marino	Vatican City
1/500th of the amount of coins minted in the same year by France	€1,944,000	€1,000,000 plus €300,000 in a year when: – the Holy See becomes vacant; – a Jubilee Year takes place; – an Ecumenical Year is opened.

was signed with Monaco.⁹ These agreements have a number of aspects in common.

First, the agreements allow the three countries to use the euro as their official currency, obliging them to grant legal tender status to euro banknotes and coins from 1 January 2002. Second, while these countries are not allowed to issue any banknotes, they are entitled to issue a specified amount of euro coins each year. In the case of San Marino and the Vatican City, the amount of coins that may be minted has been set in absolute amounts, whereas the annual amount for Monaco has been defined in terms of a ratio of the amount of coins minted by France in the same year. The amounts of euro coins that San Marino and the Vatican City are allowed to issue on an annual basis are adjusted periodically according to an Italian consumer price indicator. The agreement with Monaco does not provide for such a periodic adjustment. Table 1 gives an overview of the amounts of euro coins that the three countries are currently allowed to issue on an annual basis. The reason for the differences in the methodologies used to determine the annual amounts for San Marino and the Vatican City, on the one hand, and Monaco, on the other, is historical: the previous bilateral agreements with Italy also used absolute amounts for San Marino and the Vatican City, while a ratio of coin issuance was used in the previous bilateral agreement between France and Monaco.

The euro coins issued by the three countries must be identical to the euro coins issued by the countries of the euro area in terms of face value,

National sides of the €1 coin issued by Monaco, San Marino and the Vatican City



legal tender status, technical characteristics, artistic features of the common side and the shared artistic features of the national side. The national sides of the €1 circulation coins issued by Monaco, San Marino and the Vatican City are shown above.

Monaco, San Marino and the Vatican City are allowed to mint circulation coins, collector coins and commemorative coins. Circulation coins are issued in the denominations agreed for euro coins (1, 2, 5, 10, 20 and 50 cent and 1 and 2 euro). The circulation coins issued by the three countries are legal tender in all countries using the euro as their official currency. Collector coins are issued on the occasion of national events and denominated in values which are different from circulation coins. They are only legal tender in the country of issue. Finally, like the euro area countries, these countries are also allowed to issue commemorative circulation coins. These coins have a face value of two euro and are issued to commemorate events of historic importance.

⁹ Monetary Agreement between the Italian Republic, on behalf of the European Community, and the Republic of San Marino (2001/C 209/01 of 27.7.2001, signed on 29.11.2000); Monetary Agreement between the Italian Republic, on behalf of the European Community, and the Vatican City and, on its behalf, the Holy See (2001/C 299/01 of 25.10.2001, signed on 29.12.2000); Council Decision of 7 October 2003 on the adoption of amendments to be made to Articles 3 and 7 of the Monetary Convention between the Italian Republic, on behalf of the European Community, and the Vatican City State, represented by the Holy See, and authorising the Italian Republic to give effect to these amendments (2003/738/EC); Monetary Agreement between the Government of the French Republic, on behalf of the European Community, and the Government of His Serene Highness the Prince of Monaco (2001/L 142/59 of 31.05.2002, signed on 24./26.12.2001).

Like all other circulation coins, they are legal tender in all countries using the euro as their official currency. The totals of the face value of the circulation, collector and commemorative coins issued by Monaco, San Marino and the Vatican City have to remain within their respective annual quotas. San Marino is allowed to continue issuing gold coins denominated in “scudi”, without this having an impact on the amount of euro that it is allowed to issue annually.¹⁰ Coins denominated in scudi do not have legal tender status outside San Marino. The Vatican City is allowed to issue collector coins in a currency other than the euro, but these coins would not be legal tender in the European Community.

The euro coins of Monaco, San Marino and the Vatican City are minted at the institutions responsible for minting the French and Italian euro coins.¹¹ The costs of minting are charged to Monaco, San Marino and the Vatican City, but all revenues from issuance accrue to their national budgets.

Third, to underline the common responsibility for euro banknotes and coins, it has been agreed that Monaco, San Marino and the Vatican City will cooperate closely with the European Community to combat counterfeiting of euro banknotes and coins and suppress and punish such counterfeiting occurring within their territories.

In the case of Monaco, it has been agreed that local credit institutions will have access to euro area payment systems and Eurosystem monetary policy operations. The agreement effectively builds on the monetary arrangements between France and Monaco that were in place until end-2001, whereby all credit institutions located in Monaco were, in practical terms, treated like credit institutions located in France. They were supervised by the responsible French authorities, had access to monetary policy operations of the Banque de France under the same terms and conditions as French banks and were subject to the same minimum reserve and statistical reporting requirements. French monetary,

banking and balance of payments statistics included Monegasque data. Furthermore, credit institutions residing in Monaco participated fully in French payment systems on the same footing as French banks. The monetary agreement between the European Community and Monaco concluded at end-2001 provides for a continuation of this situation within the new context of EMU. To this end, it stipulates that Monegasque credit institutions will have access to interbank settlement and payment and securities settlement systems in the European Union under the same conditions as credit institutions in France, and will be subject to the same measures adopted by the Banque de France for the implementation of ECB provisions on monetary policy instruments and procedures as credit institutions in France. To facilitate the continuation of these arrangements following the introduction of the euro, the agreement with Monaco spells out the conditions for access by Monegasque credit institutions to euro area payment systems and Eurosystem monetary policy operations. These conditions state that Monegasque banks will remain under the supervision of the relevant French authorities and that the EU legal framework relevant for EMU, including ECB legal acts, will apply equally to Monaco. By making the EU legal framework governing the activities of credit institutions also applicable to Monaco, the European Community aims to ensure the principle of a “level playing-field” in the financial sector.

The agreements with San Marino and the Vatican City provide for the possibility that credit institutions operating within these territories will, in the future, also have access to euro area payment systems, but, so far, no such access has been established.

10 San Marino issued gold coins with a value expressed in “scudi” (singular “scudo”) for the first time in 1974.

11 In France, euro coins are minted by the “Hôtel de la Monnaie de Paris”. In Italy, this task is performed by the “Istituto Poligrafico e Zecca dello Stato”.

In order to facilitate the implementation of the monetary agreement between the European Community and Monaco, a “Joint Committee” has been established, consisting of representatives from Monaco, France, the European Commission and the ECB. The committee convenes, as a rule, on a yearly basis.

Since the beginning of 2002 Andorra has been using the euro as its currency. However, contrary to Monaco, San Marino and the Vatican City, this is not on the basis of a monetary agreement with the European Community. Andorra, which had been using French francs and Spanish pesetas until end-2001, unilaterally granted legal tender status to euro banknotes and coins on 1 January 2002.¹² In 2003, Andorra formally requested that the Community conclude a monetary agreement with it and, in 2004, the Community decided that it was prepared to open negotiations. These were initiated in 2004 and are currently ongoing.

4.2 THE EURO IN MAYOTTE, SAINT-PIERRE-AND-MIQUELON AND THE FRENCH OVERSEAS DEPARTMENTS

Four EU Member States, namely Denmark, France, the Netherlands and the United Kingdom, maintain special relationships with overseas countries and territories (OCTs), all of which are part of the respective EU Member States and, thus, do not enjoy independent status.¹³ Furthermore, these OCTs are not part of the Community; instead they enjoy a special “association” status. Part Four of the Treaty specifies the substance of this association, the general purpose of which is to “promote the economic and social development of the countries and territories and to establish close economic relations between them and the Community as a whole”. Annex 1 contains a complete overview of the monetary and exchange rate regimes applicable in the 21 OCTs associated with the Community.

Of the 21 OCTs officially associated with the Community, seven are part of a euro area country. Five of them – French Polynesia,

Mayotte, New Caledonia and Dependencies, Saint-Pierre-and-Miquelon and Wallis and Futuna Islands – are part of France. Another two – Aruba and the Netherlands Antilles – belong to the Kingdom of the Netherlands.¹⁴

By 1998, five of these OCTs had their own currency, while the French franc was the official currency of Mayotte and Saint-Pierre-and-Miquelon. As neither of these two territories are part of the European Community, implying that the euro would not have automatically replaced the French franc as of 1 January 1999, a special arrangement was agreed upon. On 31 December 1998, the EU Council explicitly decided that the euro would replace the French franc as the official currency of Mayotte and Saint-Pierre-and-Miquelon with effect from 1 January 1999 and that France would grant legal tender status to euro banknotes and coins in these territories from 1 January 2002. Unlike Monaco, San Marino and the Vatican City, Mayotte and Saint-Pierre-and-Miquelon are not entitled to issue their own euro coins.

In its decision, the Council also dealt with two related matters. Until end-1998, banks operating in Saint-Pierre-and-Miquelon had access to refinancing facilities provided by the “Institut d’Emission des Départements d’Outre-Mer” (IEDOM), a French public institution with its own legal personality and financial autonomy. The French authorities had planned for the IEDOM to continue performing the same function, from 1 January 1999, both in Mayotte and in Saint-Pierre-and-Miquelon, thereby ensuring that the banks operating in these territories had access to refinancing operations. Furthermore, the IEDOM should have been made responsible for putting euro banknotes and coins into circulation in these two territories. However, as the IEDOM did not have the status of a national central bank of the euro area,

¹² The law concerning the unilateral adoption of the euro by Andorra was passed on 11 October 2000.

¹³ While the OCTs are not independent, most of them enjoy a certain degree of autonomy.

¹⁴ The Kingdom of the Netherlands consists of Aruba, the Netherlands Antilles and the Netherlands.

especially as regards its independence, it was deemed incompatible with the Treaty and the Statute of the ESCB and of the ECB to allow the IEDOM to perform these Eurosystem tasks in the two French territories. Against this background, in its decision of 31 December 1998, the Council took note that France would reform the status and role of the IEDOM in order to ensure its compatibility with the Treaty. This has indeed been achieved by making the IEDOM an agency of the Banque de France.

Another problem concerned the issue of how to ensure that, for the sake of creating a level playing field in the financial sector, all EU legal acts relevant to EMU would also be applied in Mayotte and Saint-Pierre-and-Miquelon, given that these territories are not part of the European Community. In order to resolve this problem, the Council Decision obliges France to ensure that all relevant parts of Community legislation are applied in the two territories concerned.

The specific relations with the French territories of Mayotte and Saint-Pierre-and-Miquelon should not be confused with the status that French Guyana, Guadeloupe, Martinique and La Réunion enjoy as French departments. These four departments are an integral part of both France and of the European Community. Consequently, the euro was introduced in these four overseas departments at the same time and under the same conditions as in metropolitan France.

4.3 THE EXCHANGE RATE PEGS OF THE CAPE VERDE ESCUDO, THE CFA FRANC AND THE COMORIAN FRANC TO THE EURO

With the start of EMU, the competence not only for monetary policy but also for exchange rate policy was transferred to the Community. As a result, euro area member countries can no longer conclude exchange rate agreements with third countries. Furthermore, the transfer of competencies implies that the continuation of exchange rate agreements concluded before 1999 requires the approval of the Community.

In 1998 France and Portugal asked for their existing exchange rate agreements to be continued. In the case of France, this involved three agreements. The first was an agreement with the West African Economic and Monetary Union, consisting of Benin, Burkina Faso, Guinea-Bissau, the Ivory Coast, Mali, Niger, Senegal and Togo. France's counterpart in the second agreement was the Central African Economic and Monetary Union, which comprises Cameroon, the Central African Republic, Chad, Congo, Equatorial Guinea and Gabon. The currencies in use in these two monetary unions have the same name: the CFA franc. The third exchange rate agreement with France involved the Comoros. These agreements were intended to ensure the convertibility of the CFA and Comorian francs into the French franc at a fixed parity. Portugal had concluded an exchange rate agreement with Cape Verde with a view to allowing the convertibility of the Cape Verde escudo into the Portuguese escudo at a fixed parity. In order to ensure the convertibility of the CFA and Comorian francs vis-à-vis the French franc, and the Cape Verde escudo vis-à-vis the Portuguese escudo, both France and Portugal had provided limited credit facilities on which their counterparts under the exchange rate agreements could draw, in the event they were short of foreign exchange needed to convert domestic currency into the anchor currency.

The request to extend these exchange rate agreements and to replace the pegs to the two legacy currencies with pegs to the euro was endorsed by the Council of the European Union. As a result, the CFA franc, the Comorian franc and the Cape Verde escudo have been pegged to the euro since 1 January 1999.¹⁵ However, in its decisions of 23 November 1998 (CFA and Comorian franc) and of 21 December 1998 (Cape Verde escudo), the Council made it clear that, despite the permission to peg these three currencies to the euro, neither the Community nor the ECB nor any part of the Eurosystem

¹⁵ The fixed exchange rates are €1 = XAF 655.957, €1 = KMF 491.96775 and €1 = CVE 110.265 respectively.

would become party to the agreements. In particular, the decisions preclude any financial or other obligation on the part of the European Union and the Eurosystem as a result of these pegs and, in particular, any intervention by the ECB or the Eurosystem. Rather, all obligations under the bilateral agreements are borne by France and Portugal, with the related risks being of a budgetary nature. In this context, both France and Portugal have given assurances that the potential financial implications of the guarantees would not be substantial.

While France and Portugal have to bear all obligations under the above exchange rate agreements, they remain dependent on the Community for any amendments. Therefore, should the parties wish to change the nature or scope of the agreements, they must first submit their proposals to the Commission, the ECB and the Economic and Financial Committee in order to prepare for the procedure prescribed by Article 111(3) of the Treaty (see the section referring to the legal framework). Moreover, if the parties were to agree on a change of parity between the euro and one or more of the third currencies concerned, they would have to inform the Economic and Financial Committee.

4.4 THE EXCHANGE RATE PEG OF THE CFP FRANC TO THE EURO

In addition to the arrangements described in the previous section, a peg has also been established between the euro and the CFP franc, which is used in French Polynesia, New Caledonia and Dependencies and Wallis and Futuna Islands. The currency of these territories, which are part of France but not of the Community,¹⁶ had formerly been pegged to the French franc.

For the replacement of the former peg by a peg to the euro¹⁷ as from 1 January 1999, no specific decision by the Council was needed, unlike in the case of the Cape Verde escudo, the CFA franc and the Comorian franc. This was because the replacement had already been settled under

the Protocol on France, an annex to the Treaty. The Protocol stipulates that “France will keep the privilege of monetary emission in its overseas territories under the terms established by its national laws, and will be solely entitled to determine the parity of the CFP franc.” This also implies that, when France wants to change the parity of the CFP franc to the euro, it has the freedom to do so without being obliged to involve any Community institution.

The task of issuing banknotes and coins denominated in CFP francs has been assigned to the Institution d’Emission d’Outre-Mer (IEOM), which, like the IEDOM (see above), is also a public institution of the French Republic with its own legal personality and financial autonomy. While there are no financial links between the IEOM and the Banque de France or any other part of the Eurosystem, the Governor of the Banque de France is involved in the IEOM’s governance in his capacity as Chairman of the supervisory board of the IEOM.

4.5 POTENTIAL FUTURE MONETARY AND EXCHANGE RATE ARRANGEMENTS

All monetary and exchange rate arrangements so far entered into by the Community pertain to cases where EU Member States were engaged in bilateral arrangements of the same kind before joining the euro area. In the case of those Member States that have not yet adopted the euro, only Denmark and the United Kingdom maintain special monetary and exchange rate arrangements of a comparable nature. Accordingly, the need for similar arrangements could arise if Denmark and the United Kingdom were to join the euro area. In order to allow for a better understanding of what may be at stake in the future, a brief overview of the relevant monetary and exchange rate relations is provided below. They concern Greenland and the Faroe

¹⁶ The territories belong to the group of overseas countries and territories (OCTs) which, as explained earlier in this article, enjoy a special “association” status within the Community.

¹⁷ The fixed exchange rate is €1 = XPF 119.332.

Islands, in the case of Denmark, and the Channel Islands, the Isle of Man, the Falkland Islands, Saint Helena and Dependencies and Gibraltar, in the case of the United Kingdom.

With regard to Denmark, both Greenland and the Faroe Islands are autonomous regions within the Kingdom of Denmark. At the same time, they are not part of the Community, although Greenland has the status of overseas country and territory associated with the Community.

On the Faroe Islands, the Faroese krone banknotes and the Danish krone are both legal tender.¹⁸ The Faroese banknotes have the same denominations and sizes as the Danish banknotes and are convertible at a rate of 1:1. As there are no coins issued in Faroese krone, only Danish coins are in circulation. The authority to issue banknotes in the Faroe Islands rests with the Danish Prime Minister and is exercised in cooperation with the local government. Banknotes in Faroese krone are printed by Danmarks Nationalbank. Banks in the Faroe Islands have the same access to Danmarks Nationalbank's monetary policy operations as Danish banks. Furthermore they also fall under the supervision of the Danish Financial Supervisory Authority.

Monetary relations between Greenland are even closer, as the region is an integral part of the Danish currency area. In Greenland, only the Danish krone is legal tender. For the remainder the situation is comparable with the Faroe Islands.

As regards the situation that would arise if Denmark were to adopt the euro, the Protocol on Denmark, which is attached to the Treaty, stipulates that such a step will "not affect the right of the National Bank of Denmark to carry out its existing tasks concerning those parts of the Kingdom of Denmark which are not part of the Community."

Turning to the United Kingdom, within Europe the country maintains special monetary relations

with the Channel Islands (Jersey and Guernsey), the Isle of Man and Gibraltar. Outside Europe, this is the case of the Falkland Islands and Saint Helena and Dependencies. The Channel Islands have a specific constitutional status as British Crown Dependencies. As such they are not independent but rather possessions of the British Crown. They are part neither of the United Kingdom nor of the European Union. Each of the Crown Dependencies has the authority to issue its own currency and duly does (the Jersey pound, the Guernsey pound and the Manx pound). Both the local pounds and the pound sterling are legal tender in the relevant islands, where they are kept at parity.

Gibraltar has a special status. It is an overseas territory of the United Kingdom and, at the same time, part of the European Union.¹⁹ However, certain Community provisions do not apply to Gibraltar. Both the pound sterling and the Gibraltar pound, the latter issued by local authorities, have legal tender status in Gibraltar. The two currencies are at parity.

The Falkland Islands and Saint Helena and Dependencies have the status of British overseas territories, as well as overseas countries and territories associated with the Community. They also issue their own currency, namely the Falkland pound and the Saint Helena pound. Local pounds and the pound sterling are legal tender in the territories and are convertible at a rate of 1:1. The Falkland pound and the pound sterling are also legal tender in South Georgia and the South Sandwich Islands.

5 FINAL REMARKS

The conclusion of monetary and exchange rate relations is not an objective of the Community in itself, but rather derives from specific circumstances and needs as explained in this

¹⁸ As unlike Greenland, the Faroe Islands are not part of the group of 21 OCTs associated with the Community.

¹⁹ Gibraltar is not part of the group of 21 OCTs associated with the Community.

article. The overriding purpose of all arrangements has been to ensure the continuity of existing arrangements following the introduction of the euro and, thus, to avoid a disruption of relations. The limited number of arrangements concluded so far has functioned smoothly and has not posed any problems in terms of the pursuit of the European Union's policies, especially as regards the conduct of the ECB's monetary and exchange rate policies. At the same time, the exchange rate arrangements have helped the countries and territories concerned to develop their economic links with the Community, especially in the area of trade, on the basis of a stable exchange rate. This holds even more true for those countries and territories with which the Community has established monetary arrangements.

Annex I Prevailing monetary and exchange rate regimes in the overseas countries and territories (OCTs) associated with the Community

OCT (Member State affiliation)	Currency	Monetary and exchange rate regimes
1. OCTs where the euro has been introduced		
Mayotte (FR) Saint-Pierre-and-Miquelon (FR)	euro	The Eurosystem's monetary regime and policies apply
2. OCTs with a currency pegged to the euro		
French Polynesia (FR) New Caledonia (FR) Wallis and Futuna Islands (FR)	CFP (Change Franc Pacifique) franc	Parity with the euro is guaranteed by the French Treasury (FCFP 1000 = EUR 8.38)
3. OCTs which are part of a monetary union with a non-participating EU Member State		
Greenland (DK)	Danish krone	Greenland is part of the Danish currency area
4. OCTs which operate a currency board with a peg to the currency of a non-participating EU Member State		
Falkland Islands (UK)	Falkland pound (FKP) and pound sterling	Currency board with a peg to the pound sterling (FKP and SHP: GBP = 1:1)
South Georgia and the South Sandwich Islands (UK)	Falkland pound (FKP) and pound sterling	
Saint Helena and Dependencies (UK)	Saint Helenian pound (SHP) and pound sterling	
5. OCTs which have pegged their own currency to the US dollar		
Aruba (NL)	Aruban guilder	Unilateral peg to the US dollar
Netherlands Antilles (NL)	Antillean guilder	Unilateral peg to the US dollar
Bermuda (UK)	Bermudian dollar	Unilateral peg to the US dollar
Cayman Islands (UK)	Cayman dollar	Currency board with a peg to the US dollar
6. OCTs which are part of a monetary union with third countries		
Anguilla (UK) Montserrat (UK)	Eastern Caribbean dollar	Part of the Eastern Caribbean Currency Union, which operates a currency board with a peg to the US dollar ¹⁾
7. OCTs which have unilaterally adopted a non-EU currency		
Pitcairn Islands (UK)	New Zealand dollar	Unilateral (New Zealand) dollarisation
Turks and Caicos Islands (UK) British Virgin Islands (UK)	US dollar	Unilateral dollarisation
8. OCTs without a currency		
French Southern and Antarctic Territories (FR) ²⁾ British Antarctic Territory (UK) British Indian Ocean Territory (UK)	no currency	-

1) The following countries are members of the Eastern Caribbean Currency Union: Anguilla, Antigua and Barbuda, Dominica, Grenada, Montserrat, St. Kitts and Nevis, St. Lucia and St. Vincent & the Grenadines.

2) The Antarctic Treaty, which was signed on 1 December 1959 and entered into force on 23 June 1961, establishes the legal framework for the management of Antarctica. At the end of 2003 there were 45 treaty member nations: 28 consultative and 17 non-consultative. The consultative members include the seven nations that claim portions of Antarctica as national territory. The claimant nations are Argentina, Australia, Chile, France, New Zealand, Norway and the United Kingdom (source: CIA, The World Factbook). These claims are not recognised by the Antarctic Treaty.