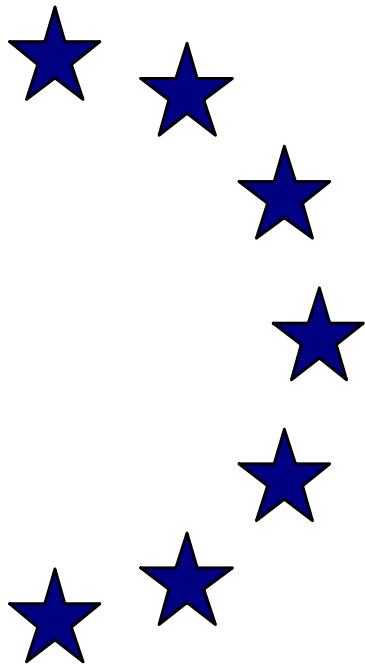


EUROPEAN ECONOMY

EUROPEAN COMMISSION

DIRECTORATE-GENERAL FOR ECONOMIC
AND FINANCIAL AFFAIRS

ECONOMIC PAPERS



ISSN 1725-3187

http://europa.eu.int/comm/economy_finance

N° 255

September 2006

**Monetary and exchange-rate agreements
between the European Community
and Third Countries**

by

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Directorate-General for Economic and Financial Affairs

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European Commission
Directorate-General for Economic and Financial Affairs
Publications
BU1 - -1/13
B - 1049 Brussels, Belgium

ISBN 92-79-01196-0

KC-AI-06-255-EN-C

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ECONOMIC PAPER

MONETARY AND EXCHANGE-RATE AGREEMENTS BETWEEN THE EUROPEAN COMMUNITY AND THIRD COUNTRIES

1. Executive summary

On 1 January 1999, the euro became the single currency of eleven EU Member States, thereby replacing the different national currencies at the respective irrevocably fixed conversion rates. The Member States concerned ceded their monetary policy powers to the European System of Central Banks (ESCB)¹ and², while the Council of Ministers became responsible for the euro area's exchange-rate policy. The participating Member States thus lost their competence to decide on monetary and exchange rate policy issues, and hence also to conclude monetary or exchange-rate agreements with third countries. Such agreements have now come within the exclusive competence of the Community as far as they relate to the euro.

As a consequence of this transfer of competence, pre-existing bilateral agreements between participating Member States and third countries had to be reconsidered by the Community. Given the regime change entailed by the introduction of the single currency, most had to be re-established on a new footing, i.e. on the basis of Art. 111.3 EC, which constitutes the legal basis for concluding formal monetary and exchange rate agreements with third countries. At the same time, it had been agreed that the basic principles of the bilateral currency arrangements concluded with these third states before 1 January 1999 (stage three of the EMU) had to remain unaltered for continuity reasons.

The purpose of this Paper is to offer an overview of the monetary and exchange rate agreements between the EC and third countries which have been concluded under Art 111.3 EC. All these agreements pertain to cases where participating EU Member States had concluded bilateral arrangements of the same type before joining the euro area. The conclusion of monetary and exchange rate agreements is indeed not an objective of the Community, but results from specific circumstances and needs. The main objective of all arrangements concluded so far is therefore to ensure the continuity of existing relations following the introduction of the euro. As recently underlined by the ECB (ECB, 2006), these agreements have satisfactorily worked and have not hindered the functioning of the euro area. On the contrary, they have fostered the development of deep and stable economic relations, notably in the trade area, with the Community thanks to the stable exchange rates involved or thanks to the sharing of the same currency.

The paper firstly examines the exchange rate agreements concluded by EU Member States. They usually can be traced back to the end of the colonial era. They have been endorsed by the Community since then. This notably applies to the agreements between

¹ The Member States retain their responsibility for economic policy.

² The ESCB consists of the European Central Bank and the EU national central banks.

France and two African economic and monetary unions: the West African Economic and Monetary Union (involving Bénin, Burkina Faso, Guinea-Bissau, Ivory Coast, Mali, Niger, Senegal and Togo), and the Economic and Monetary Community of Central Africa (involving Cameroon, Central African Republic, Chad, Congo, Equatorial Guinea and Gabon). The agreements between France and the Comoros as well as between Portugal and Cape Verde are also discussed. In all these cases, France and Portugal have been allowed to continue their existing agreements with the CFA countries and with Cape Verde following the substitution for the French franc and the Portuguese escudo of the euro. Under these exchange rate agreements, the African countries concerned agreed with France and Portugal, respectively, on a particular exchange rate for the currencies concerned against each other. These agreements were accompanied by specific provisions ensuring that the agreed exchange rate is sustainable in the long term. The wish to benefit from such stable exchange rates vis-à-vis the French franc and the Portuguese escudo (and now with the euro) was mainly motivated by considerations of a political and historical nature as well as by trade flow considerations. The wish to benefit from a solid and sustainable framework in view of sound and stable monetary conditions also played a key role.

The paper subsequently examines the monetary agreements which the Community has concluded with third countries, i.e. the agreements concluded with Vatican City State, Monaco and San Marino. The main motivation for introducing the euro in these third countries was that these countries were using a legacy currency of the euro as their official currency prior to the introduction of the euro. The most natural solution for the disappearance of these national currencies was to replace them with their successor currency, namely the euro. The Conference at Maastricht in 1992 therefore indicated in Declaration No. 6 that the existing monetary relations between Italy and San Marino and the Vatican City as well as between France and Monaco remained unaffected by the EC Treaty until the introduction of the single currency and that the Community would facilitate the renegotiations of existing arrangements as might become necessary as a result of the introduction of the single currency. Because of the historical character of the monetary links, France and Italy were given respective mandates by the Council to negotiate and to conclude monetary agreements on behalf of the Community, while the Commission and the ECB were fully associated. The resulting monetary agreements typically imply that these third countries are allowed by the Community to use the euro as their own official currency and to grant it legal tender status within their own boundaries. Vatican, Monaco, and San Marino are moreover allowed to issue a limited quantity of euro coins. In exchange, the three micro-states have undertaken to apply certain Community rules relating to euro banknotes and coins. They also agreed to co-operate closely with the Community with regard to measures against the counterfeiting of euro banknotes and coins, and to suppress and punish any counterfeiting on their territory. In the case of Monaco, substantial additional commitments were obtained. This was notably due to the fact that the agreement was also directly setting the terms and conditions for Monegasque banks to have access to the euro area payments and settlement systems and to the Eurosystem's monetary policy operations.

The particular case of the legal arrangements created for Saint Pierre-et-Miquelon and Mayotte is also discussed. Both are overseas territories of France which do not form part of the Community, and as such are third territories for the Community. Nevertheless, in the run up to the third stage of EMU, and given that these territories already used the French franc, the Council decided to allow for the official introduction of the euro in these territories.

Accessoryly, the paper discusses informal monetary regimes of third countries involving the Community. This is the case of third countries and territories using the euro de facto (but not de iure) such as Andorra, Montenegro and Kosovo.

The paper provides a brief institutional and historical overview for each zone, country or territory as well as the type of monetary link with the Community as well as the economic rationale thereof.

Annex 1 provides basic factual and economic information relating to the different countries and territories: area, population, median age, PPP per capita, inflation rate, unemployment rate, main export partner and share, main import partner and share.

Annex 2 details the main provisions of the monetary agreements with Vatican City, San Marino and Monaco.

Annexes 3 and 4 cover the monetary and exchange rate links between the EC and some of its Member States' overseas entities and territories, which can however not be qualified as third countries. A distinction is made between Member States' overseas "entities" which are part of the Community and the overseas "territories" which do not form part of it.

Annex 5 covers the situation of third countries using the currency of a non-participating Member State, in particular the situation of the Channel Islands and of the Isle of Man, which issue sterling-denominated notes and coins.

Finally, a series of geographical maps helps the reader to identify the precise location of the various countries and overseas entities or territories discussed.

2. The EC legal basis for concluding monetary and exchange rate agreements: Art 111 EC

The Maastricht Treaty has introduced a specific article for concluding monetary or exchange rate agreements (Art 111) containing several paragraphs, covering different types of agreements³. To date, the Council has only enacted the third type of agreement (Art 111.3 EC).

Art 111 EC paragraph 1

By way of derogation from Article 300 EC (the general legal basis for concluding agreements with third countries), the Council may conclude formal agreements on an exchange-rate system for the euro in relation to non-Community currencies⁴. This provision essentially confers the right to the Council to conclude a possible future Bretton Woods-type arrangement. The Council shall act unanimously on a recommendation from the ECB or from the Commission, after consulting the ECB in an endeavour to reach a consensus consistent with the objective of price stability and after consulting the European Parliament. Using a similar procedure, the Council may also adopt, adjust or abandon the central rates of the euro within the exchange-rate system (by a qualified majority).

It appears that while the ECB needs to be consulted in an endeavour to reach a consensus consistent with the objective of price stability, the Council has the final say and the ECB is bound by its decision, if no consensus is reached. In such a case the predominance of finance ministers is certain, but the Treaty provisions make sure that the ECB has ample room to express its views (Kutos, 2001).

Art 111 EC paragraph 2

In the absence of a formal exchange-rate system in relation to one or more non-Community currencies, the Council may formulate general orientations for exchange-rate policy in relation to these currencies⁵. The paragraph was drafted with informal agreements in mind, such as the Plaza and the Louvre agreements (the G5 Plaza agreement of 1985 aimed at an orderly reversal of the dollar's overvaluation, while the G-6 Louvre agreement of 1987 was geared at maintaining exchange rates within informal "target zones" around prevailing levels). However, it does not explicitly address the issue of informal arrangements but restricts its coverage to unilateral position-taking (Kutos, 2001). In such cases, the Council shall act by a qualified majority either on a recommendation from the Commission and after consulting the

³ The Exchange Rate Mechanism (ERM II) of the Community, dealing with the exchange rate relations between the euro and other Community currencies, is not covered by Art 111 EC. The latter exclusively covers the relations between the euro and non-Community currencies.

⁴ Art 111.1 reads as follows: « *By way of derogation from Article 300, the Council may, acting unanimously on a recommendation from the ECB or from the Commission, and after consulting the ECB in an endeavour to reach a consensus consistent with the objective of price stability, after consulting the European Parliament, in accordance with the procedure in paragraph 3 for determining the arrangements, conclude formal agreements on an exchange-rate system for the euro in relation to non-Community currencies. The Council may, acting by a qualified majority on a recommendation from the ECB or from the Commission, and after consulting the ECB in an endeavour to reach a consensus consistent with the objective of price stability, adopt, adjust or abandon the central rates of the euro within the exchange-rate system. The President of the Council shall inform the European Parliament of the adoption, adjustment or abandonment of the euro central rates* ».

⁵ Art 111.2 reads as follows: « *In the absence of an exchange-rate system in relation to one or more non-Community currencies as referred to in paragraph 1, the Council, acting by a qualified majority either on a recommendation from the Commission and after consulting the ECB or on a recommendation from the ECB, may formulate general orientations for exchange-rate policy in relation to these currencies. These general orientations shall be without prejudice to the primary objective of the ESCB to maintain price stability* ».

ECB or on a recommendation from the ECB. These general orientations shall be without prejudice to the primary objective of the ESCB to maintain price stability.

If one compares paragraph 1 with paragraph 2, it appears that the general orientations “shall be without prejudice to the primary objective of the ESCB to maintain price stability”. Since it has been left exclusively to the ECB to define “price stability”, this qualification has mostly been read as creating considerable leeway for the ECB.

Art 111 EC paragraph 3

By way of derogation from Article 300 EC (see above), where agreements concerning monetary or foreign-exchange regime matters need to be negotiated by the Community with one or more States or international organisations, the Council shall decide the arrangements for the negotiation and for the conclusion of such agreements⁶.

Article 111.3 EC sets out the modalities for negotiating and concluding such agreements, without however specifying which issues (obviously different from the exchange rate systems covered in Article 111.1 EC) might fall under “monetary, or foreign exchange, regime matters” (Kutos, 2001).

In practice, Article 111.3 has so far been used as the legal basis for Council decisions on monetary and exchange rate relations with a number of third countries that have close links to the euro area:

- *exchange rate agreements*: with the CFA zone, the Comoros and Cape Verde;
- *monetary agreements*: with the Vatican City State, the Principality of Monaco and the Republic of San Marino.

This provision will be of primary interest in the present paper.

Art 111 EC paragraph 5

Art 111.5 is merely of a declaratory nature⁷ and provides that the Member States may conclude international agreements only where the Community has no competence. Member States’ external competence in the EMU-related issues (the general Community competence as regards Economic and Monetary Union) could only exist where there is no prejudice to the Community competences in this field: e.g. Member States are allowed to negotiate in international bodies and conclude international agreements on economic matters, which largely remain a national competence (subject to co-ordination foreseen in the Community framework) (Kutos, 2001).

⁶ Art 111.3 reads as follows: “*By way of derogation from Article 300, where agreements concerning monetary or foreign-exchange regime matters need to be negotiated by the Community with one or more States or international organisations, the Council, acting by a qualified majority on a recommendation from the Commission and after consulting the ECB, shall decide the arrangements for the negotiation and for the conclusion of such agreements. These arrangements shall ensure that the Community expresses a single position. The Commission shall be fully associated with the negotiations. Agreements concluded in accordance with this paragraph shall be binding on the institutions of the Community, on the ECB and on the Member States*”.

⁷ Art 111.5 reads as follows: “*Without prejudice to Community competence and Community agreements as regards economic and monetary union, Member States may negotiate in international bodies and conclude international agreements*”.

3. Types of agreements with third countries and territories

The present section distinguishes between the exchange rate agreements and the monetary agreements concluded by the Community with third countries.

An exchange rate agreement typically aims at establishing a certain parity between the currencies of the countries involved. A monetary agreement generally implies that a third country is allowed to officially use another country's currency as its own official currency and occasionally to give it legal tender status within its own boundaries (see Box 1). In certain cases, the third country can even be allowed to issue a limited quantity of currency (Vatican, Monaco, San Marino and Andorra – see below pp. 32-36 and 40-41).

Box 1 : When is money legal tender?

Each country can determine what constitutes legal tender within its borders. Contrary to common opinion, legal tender and money are not necessarily synonymous. Neither is legal tender a mean of payment that must be accepted by the parties to a transaction. Legally, it is only defined as a mean of payment that cannot be refused by a creditor in satisfaction of a debt. Therefore, legal tender status only refers to the settlement of debts (Taylor, 2005).

However, the concept applies only to banknotes and coins issued by the central banks or coins issued by the governments. Even if some other form of payment may be considered as quasi-money and admitted by law or custom, for instance when it has exactly the same consequence as remitting notes and coins corresponding to the amount due, it is not legal tender. This certainly affects the factual importance and the global relevance of the concept of legal tender from an economic point of view, even though not from a legal point of view (Fidal, 2000).

Exchange rate or monetary agreements often include specific provisions destined to ensure that the defined exchange rate or the monetary union is sustainable in the long term.

Both types of agreements, as interpreted by Bubula and Otker-Robe in Box 2 (2002), reflect relatively close forms of hard pegged regimes. Bubula and Otker-Robe indeed distinguish different forms of a pegged regime between various currency regimes:

- *euroisation*: it constitutes in the authors' view the most extreme form of a pegged regime: this type of currency regime covers the monetary agreements concluded by the Community with third countries such as Vatican, Monaco and San Marino, even though euroisation in these cases is bilaterally agreed with the Community under Art 111.3 EC (see pages 32-36). Andorra, Kosovo and Montenegro constitute cases of unilateral euroisation (see pages 40-43);
- *monetary union*: this covers the currency regimes of the euro area (UEM/EMU), the two CFA franc areas and the CFP area;
- *currency board arrangement*: this i.a. covers the currency regimes unilaterally established by Bosnia-Herzegovina, Bulgaria, Estonia and Lithuania. Estonia and Lithuania moreover participate in the ERM II mechanism (see infra);

Box 2 : IMF classification of various currency regimes (Bubula and Otker-Robe, 2002)**1. Exchange rate regimes with another currency as legal tender (formal dollarization or euroisation)**

The country uses the currency of another country, which circulates as the sole legal tender. Dollarisation/euroisation is a complete surrender of the authorities' independent control over domestic monetary policy, and as such, can be viewed as the most extreme form of a pegged regime. *Examples of mutually agreed euroisation: Vatican, San Marino, Monaco. Examples of unilateral euroisation: Andorra, Kosovo, Montenegro.*

2. Exchange rate regimes with no separate legal tender (currency/monetary union)

The member belongs to a monetary or a currency union, in which it shares the same legal tender. By adopting such regimes, the authorities also surrender control over domestic monetary policy and, hence, such regimes are also viewed as a hard exchange rate peg. *Examples: euro area, CFA area and CFP area.*

3. Currency Board Arrangements

An exchange rate regime based on an explicit legislative commitment to exchange domestic currency for a specified foreign currency (e.g. the euro) at a fixed exchange rate, combined with restrictions imposed upon the issuing authority to ensure the fulfilment of its legal obligation. This implies that domestic currency remains fully backed by foreign assets (e.g. denominated in euros), thus eliminating traditional central bank functions such as monetary control and lending of last resort. While leaving little scope for discretionary monetary policy, some flexibility may be afforded depending on the strictness of the board's rules. *Examples: Estonia, Lithuania, Bulgaria, Bosnia-Herzegovina.*

4. Conventional Fixed Peg Arrangements: vis-à-vis a single currency or a basket of currencies

The country (formally or de facto) pegs its currency at a fixed rate to another currency or a basket of currencies. There is no irrevocable commitment to preserve the parity. The exchange rate may fluctuate within a narrow margin around a central rate or the maximum and minimum value of the exchange rate remains within a narrow margin. The authorities stand ready to defend the fixed parity through direct (i.e. via sale/purchase of foreign exchange in the market) or indirect intervention (e.g. via aggressive use of interest rate policy, imposition of foreign exchange regulations or exercise of moral suasion that constrain foreign exchange activity, or through intervention by other institutions). Flexibility of monetary policy, though limited, is greater than in hard pegs, as traditional central banking functions are still possible, and the authorities can adjust the level of the exchange rate, though relatively infrequently. *Examples: Cape Verde, Comoros, but also the CFA and CFP areas as regards their relationships with the euro.*

Box 2 (continued): IMF classification of various currency regimes

5. Pegged exchange rates within a horizontal band

The currency is allowed to move within certain margins of fluctuation around a formal or a de facto fixed central rate. The authorities stand ready to defend the limits of the band through direct or indirect intervention to maintain the exchange rate within these limits. Some limited degree of monetary policy discretion can be afforded, with the degree of discretion depending on the band width. *The ERM II mechanism operating with the narrow band or normal band is an example of a bilateral system of pegged exchange rates within a horizontal band. Pegged exchange rates within a horizontal band can also be unilateral.*

6. Crawling pegs

The currency is adjusted periodically vis-à-vis a single currency or a basket in small amounts at a fixed rate or in response to changes in selective quantitative indicators (past inflation differentials with major trading partners, etc). Maintaining a credible crawling peg imposes similar constraints on monetary policy as a fixed peg system, as the authorities are expected to intervene to ensure the targeted fixed depreciation path.

7. Pegged exchange rates within crawling bands

The currency is maintained within fluctuation margins around a formal or a de facto central rate, which is adjusted periodically in small amounts at a fixed rate, or in response to selective quantitative indicators. The commitment to maintain the exchange rate within the band continues to impose constraints on monetary policy, with the degree of policy independence as a function of the bandwidth. *Examples: Romania.*

8. Tightly or other managed floating with no predetermined path for the exchange rate

The authorities influence exchange rate movements through active intervention to counter the long-term exchange rate trend, without specifying a predetermined exchange rate path, or without having a specific exchange rate target (“dirty float”). Intervention may be direct or indirect. Indicators for managing the rate are broadly judgmental (e.g. BOP position, international reserves, etc), and adjustments may not be automatic. Tightly managed floating takes the form of very tight monitoring that generally results in a stable exchange rate without having a clear exchange rate path, so as to permit the authorities an extra degree of flexibility in deciding the tactics to achieve the desired path. In other regimes of managed floating, the exchange rate is influenced in a more ad hoc fashion.

9. Independent floating

The exchange rate is determined by the market; any foreign exchange intervention aims at moderating the rate of change and preventing undue fluctuations in the exchange rate that are not justified by economic fundamentals, rather than establishing a level for the exchange rate. In these regimes, monetary policy is in principle independent of exchange rate policy. *Examples: euro area, Poland, Sweden, and the United Kingdom.*

- *conventional fixed peg arrangement*: this covers the CFA franc area as regards its relationship with the euro (see pages 17-27), but also the cases of Cape Verde and the Comoros (see pages 28-30), as agreed with the Community under Art 111.3 EC. In the case of the exchange rate agreements, it is possible to modify the exchange rate under certain conditions. As regards the CFA agreements, a change of parity occurred in 1994 and resulted in a devaluation of 50 % of the CFA franc against the French currency (see infra Box 3). As regards Cape Verde, the parity was changed (see page 30) only once in late 1998. The institutional framework underpinning the exchange rate level of the CFA franc is generally seen as sufficiently robust and independent to be credible and to remove the risk of commitment breaches;
- *pegged exchange rates within a horizontal band*: this category includes the ERM II mechanism in which Denmark, Estonia, Cyprus, Latvia, Lithuania, Malta and Slovenia currently participate. The participation in ERM II is not covered by Art 111 (which only relates to third countries), but by other types of agreements;
- *other less constraining or more independent currency regimes*: crawlings pegs, pegged exchange rates within crawling bands, tightly or other managed floating with no predetermined path for the exchange rate, independent floating. These currency regimes are in general, if not always, unilateral.

The wish to benefit from a stable exchange rate or a monetary union vis-à-vis a third currency⁸ is generally motivated by considerations of an historical nature as well as by actual or desired economic integration and by trade flows (main export/import partners) considerations. The small size of a country and its relatively high degree of trade openness also play a considerable role in the decision to enter into an exchange rate or a monetary agreement with another country. Bordo and Jonung (2003) and other researchers (Cohen, 1993) insist on the prominence of the political will to explain the rise and fall of monetary cooperation/unions: “Economic and organisational factors matter, but interstate politics appears to matter most of all” (Cohen, 1993).

3.1. Historical and political background of the exchange rate and monetary agreements concluded or endorsed by the Community

The exchange rate agreements concluded by France and Portugal and subsequently endorsed by the Community under Art 111.3 EC can be traced back to the end of the colonial era. All third countries involved in these agreements are indeed former French or Portuguese colonies. The sole exception is Equatorial Guinea, which is a former Spanish colony.

The monetary agreements concluded with the Vatican City State, the Principality of Monaco and the Republic of San Marino result from a commitment of continuity made at Maastricht in 1992 (Declaration No. 6) that the Community would facilitate the renegotiations of already existing monetary agreements between Italy and the Vatican City and San Marino as well as between France and Monaco as might become necessary as a result of the introduction of the single currency in the Community. The three European

⁸ In the case of the exchange rate agreements concluded by France and Portugal in the past, and subsequently endorsed by the Community, the credit facilities offered by the anchor countries and needed to finance the current account deficits of the beneficiary countries constitute a core element. These credit facilities can be used in the event the beneficiary countries are short of foreign exchange needed to convert domestic currency into the anchor currency.

microstates had already adopted the currency of a future EC Member State as early as the 19th or early 20th century⁹ (see infra).

3.2. *Economic rationale of the exchange rate and monetary agreements concluded or endorsed by the Community: theoretical aspects (Winkler, Mazzafaro, Nerlich and Thimann, 2004)*

Beyond the historical or institutional reasons which have led to the above mentioned monetary or exchange rate agreements, there are usually also purely economic reasons. In this respect, one can single out the following *economic benefits of close monetary co-operation* (this formulation covers both “hard pegged” exchange rate agreements and mutually agreed euroisation):

- *macroeconomic stability*: by adopting the monetary policy of the reference country, which is generally perceived as enjoying a high degree of credibility, inflation and interest rates are assumed to converge towards the levels of the reference country. Moreover, if a currency’s risk premium is mainly influenced by exchange rate considerations, close monetary co-operation can reduce the risk premium, because the risk of a sharp and sudden devaluation will be mitigated;
- *better access to the international capital markets*: this results from lower currency risks, higher financial sector stability, lower risks of the sudden introduction of capital controls and lower information costs;
- *development of the country’s financial sector*: a stable currency is a precondition;
- *importance of economic and financial links with the reference country*: this is particularly true for trade, but could also positively affect real convergence in terms of GDP, convergence of business cycles and symmetry of shocks;
- *reduction of transaction costs*: the saving is proportional to the number of transactions conducted in foreign currency, i.e. depends on the degree of trade openness of the economies concerned and the share of trade invoiced in the reference currency. Small countries, whose trade openness is generally higher than the one of the larger countries¹⁰, are expected to benefit most from such savings. These savings add to the positive effects on trade resulting from the lower transaction costs themselves and the elimination of currency risks.

Among the *costs associated with close monetary co-operation*, the following can be identified:

- *the loss of domestic monetary adjustment mechanisms (for monetary agreements, not for exchange-rate agreements)* : such mechanisms can be

⁹ The Papal States had already linked their currency to the lira in 1867 and the Italian lira was already legal tender in Vatican City, when the Lateran Treaties signed in 1929 formalised the Vatican City State’s right to issue its own lira coins; the framework for the monetary relations between France and Monaco was covered by the Monegasque ordinance of 1925, but Monaco had been part of the French monetary system since very long, when it began issuing franc coins (after the French Revolution); the monetary links between Italy and San Marino were governed by the Friendship and Good-Neighbourship Convention signed in 1939, but San Marino already used the Italian lira for its monetary system after Italy unified in 1870.

¹⁰ A larger share of all transactions conducted by the small countries’ residents is with non-residents.

used to cope with asymmetric shocks or diverging business cycles. In their absence, the country has to rely on other adjustment mechanisms;

- *the loss of the lender of last resort function (for monetary agreements¹¹, not for exchange-rate agreements)*: the amount available to recapitalise distressed banks is limited to the country's foreign exchange reserves;
- *the loss of seigniorage revenues from issuing a domestic currency^{11and12}*: this loss can be significant for countries with large informal sectors, underdeveloped tax systems and high inflation. It appears generally limited to a maximum of 1 or 2 % of GDP, which can be regarded as not significant when compared with the potential benefits of a developed tax system and monetary stability. African countries heavily relied on seigniorage in recent years (1.8 % of GDP per annum in the period 1980-97). However, the Mediterranean EU countries quickly adjusted their policies to absorb the loss of seigniorage resulting from the adherence to a hard currency policy. This makes it further doubtful whether high seigniorage income should be seen as an important argument against achieving currency stability (Honohan and Lane, 2001).

As regards the economic rationale and the sustainability of exchange rate and monetary agreements, two theories provide assessment criteria (see Winkler, Mazzaferro, Nerlich and Thimann, 2004):

- *the credibility theory*: this theory analyses the credibility of monetary commitments when confronted with externally-induced currency crises. It attributes limited virtues to monetary policy discretion. It moreover pays little attention to economic integration issues, due to endogenous integration tendencies of close monetary co-operation. According to this theory, economic integration is more the result (ex post integration) of the adoption of a foreign currency than a prerequisite (ex ante integration). This theory focuses on nominal convergence and tends to overestimate the number of countries which could be eligible to closer economic co-operation.

In the 1990ies, under conditions of an increasingly open capital account and free movement of capital, soft pegs arrangements appeared unsustainable and either flexible exchange rates or hard pegs appeared preferable, in particular for emerging market economies. Credibility was the key issue, given that countries with a low degree of monetary policy credibility were not able to use the monetary policy tool to reduce output fluctuations. The use of monetary policy had even destabilising effects and increased interest rates and exchange rates volatility. Therefore, close monetary co-operation with a country benefiting from a sound track record in terms of monetary and financial stability appeared the best way to stabilise the economy and foster lower interest rates, non-inflationary growth and financial sector development.

¹¹ And depending on the content of the agreements.

¹² For the issuing country, the introduction of its currency in third countries and territories can result in an increase in seigniorage revenues. Cooperation in other areas, such as the fight against counterfeiting, money laundering, tax evasion, banking supervision and regulation can constitute additional benefits. Close monetary cooperation can also be used as a means for furthering economic, financial and political relations with third countries.

The theory concludes that for countries with a low credibility and hence low effectiveness of monetary policy, the cost of losing the monetary policy instrument is negligible. At the same time, the benefits in terms of credibility and stability are potentially high.

- *the “optimal currency area” theory*: it emphasises the need for an adjustment mechanism in case of asymmetric shocks and unsatisfactory levels of economic integration. Moreover, it highlights the importance of economic and financial integration as a prerequisite for successful monetary cooperation and evaluates the effectiveness of other adjustment mechanisms: price and wage flexibility, mobility of production factors, etc (see infra). The theory emphasises real convergence issues and tends to underestimate the number of countries which could be eligible to closer economic co-operation.

The main adjustment mechanisms that can substitute for monetary policy are price and wage flexibility, mobility of production factors, of which labour is the most important. The degree of diversification in production and consumption indicates whether economies are expected to face similar shocks and have convergent business cycles. A high degree of trade and financial integration is seen as reducing the risk of asymmetric shocks and increasing the convergence in business cycles. Fiscal and political integration with the reference country could play the role of shock absorber.

4. Formal exchange-rate agreements with third countries or territories

The Community's decision to take over the existing exchange-rate agreements of two of its euro-area Member States (France and Portugal) became effective on 1 January 1999, following the transfer of competence for exchange-rate matters to Community level. This covered the exchange rate agreements concluded by France with two groups of African countries in the past (see infra), as well as the agreement concluded by Portugal with Cape Verde. The Community did not conclude any new agreements with these third countries, but instead allowed the two Member States concerned to continue the existing agreements. The basic principles of the bilateral currency arrangements concluded between France, Portugal and these third states (before 1 January 1999, i.e. the beginning of the stage three of EMU) had to remain unaltered for the sake of consistency with the basic principles of international law ("pacta sunt servanda")¹³.

The agreements concluded with the African countries take the form of fixed peg arrangements. Given the particular framework introduced for ensuring the credibility of the exchange rates (see infra), the peg arrangement can be assimilated with a hard exchange rate peg and thus be considered as being stronger than a conventional fixed peg arrangement.

The beneficiary countries are not allowed to use the euro as their official currency nor to grant legal tender status to it.

4.1. The CFA franc zone

Fielding and Shields (2000) consider that the CFA franc zone represents an alternative way of achieving a "hard" currency peg that embodies only somewhat more flexibility than a currency board. Indeed, a devaluation can only be achieved by mutual consent of all the members of the union and France, i.e. by unanimity of fifteen countries, and subject to prior information of the Economic and Financial Committee¹⁴.

There was some logic for these countries to maintain the exchange rate links with the French franc after their independence and with the euro afterwards. The overall size of the economy of the African countries concerned is not large enough to represent a substantial currency bloc on its own. Moreover, there is no obvious internal anchor country for the CFA countries, even though countries like Côte d'Ivoire, Sénégal, Cameroon and Gabon assume economic leadership in their respective areas. But none has a track record of financial stability (Honohan and Lane, 2001).

The CFA franc zone has some similarities with EMU as regards the progressive deepening and widening regional integration. Initiated by France in 1939, it could in certain respects even be considered as a precursor of EMU. On the other hand, European integration proceeded from economic integration to monetary union. The CFA franc zone proceeded in the reversed order (Strauss-Kahn, 2003). Moreover, the primary driving force behind EMU has been the

¹³ Even though Art 307 EC does not apply in the present case, given that the CFA agreements were concluded by France after the entry into force of the Treaty of Rome.

¹⁴ The EFC Committee delivers opinions at the request of the Council or of the Commission, or on its own initiative, for submission to those institutions. It keeps under review the economic and financial situation of the Member States and of the Community. It contributes to the work of the Council. It examines the situation regarding the movement of capital and the freedom of payments.

politics of European integration, while there has been no strong impetus for African political integration so far (Honohan and Lane, 2001).

a) The CFA franc zone as two separate currency unions

The CFA franc zone consists of two distinct currency unions, the West African Economic and Monetary Union (UEMOA or WAEMU – see infra) and the Economic and Monetary Union of Central Africa (CEMAC or CAEMC – see infra). The WAEMU consists of Benin, Burkina-Faso, the Ivory Coast, Guinea-Bissau, Mali, Niger, Senegal and Togo (see Map 1). The CAEMC member states are Cameroon, the Central African Republic, Chad, Congo, Equatorial Guinea and Gabon (see Map 1). France has concluded exchange rate agreements with both currency unions and with the Comoros. The arrangements find their origin in the colonial era and can formally be traced back to the end of this period (see Box 3).

The *West African Economic Monetary Union* (Box 4) is a regional entity established by a Treaty which was signed in 1973 and completed in 1994. The aim of the Treaty—built on the achievements of the West African Monetary Union, established in 1962—was to create a new framework for

Box 3: The origins and the legal basis of the CFA franc zone

The CFA franc zone dates back to 1939 (Strauss-Kahn, 2003), even though French West Africa already issued its own banknotes as from 1901, via the Banque de l'Afrique Occidentale, which circulated also in French Equatorial Africa. The “franc des Colonies françaises d'Afrique” was formally introduced in 1945 (under the Bretton Woods system), and the circulation of Banque de France banknotes was no longer tolerated from that time (Taylor, 2005). In 1958, its name was changed into “franc de la Communauté française d'Afrique”. Today, the « CFA » franc stands for “franc de la Communauté financière africaine (WAEMU) or “franc de la Coopération financière en Afrique centrale” (CAEMC).

The legal basis of the CFA franc zone is composed of a complex set of Treaties and Agreements (Diallo, 2002):

- a) Agreements between the African States themselves:
 - for CAEMC: Convention of monetary co-operation signed in November 1972 and revised in March 1994 and July 1996;
 - for WAEMU: Treaty establishing the monetary union signed in November 1973 and completed in January 1994.
- b) Agreements between the African states and France:
 - for CAEMC: Convention of monetary co-operation signed in November 1972;
 - for WAEMU: Agreement of monetary co-operation signed in December 1973;
 - for the Comoros: Agreement of monetary co-operation in November 1979;
 - for CAEMC and WAEMU: Conventions establishing the mechanism of the "operations accounts" respectively in March and December 1973;
 - for the Comoros: Convention establishing the mechanism of the "operations account" in November 1979.

The Treaties were inspired by the monetary co-operation arrangements in place between the common central banks since the late fifties-early sixties.

fostering the achievement of member countries' growth and development objectives. It was also meant to provide the credibility required to sustain the fixed exchange rate for the common currency.

The Union has a single central bank, the Central Bank of West African States (Banque Centrale des Etats de l'Afrique de l'Ouest (BCEAO)), with headquarters in Dakar and national branches in the member states. WAEMU comprises seven francophone countries: Benin, Burkina Faso, Ivory Coast, Mali, Niger, Senegal, and Togo. Its eighth member country, Guinea-Bissau, is a former Portuguese colony. Mali and Guinea-Bissau joined the Union in 1984 and 1997, respectively. The BCEAO issues the common currency of the WAEMU member countries, the CFA franc.

The *Central African Economic and Monetary Community* (Communauté économique et monétaire de l'Afrique centrale – CEMAC or CEAMC – Box 5) was established by a Treaty signed in 1972 and revised in 1994 and 1996. It was ratified by six states: Cameroon, the Central African Republic, Chad, the Republic of Congo, Equatorial Guinea and Gabon. The Treaty was based on the monetary co-operation arrangements in effect under the common central bank since 1959 and on those of the Customs and Economic Union of Central Africa – UDEAC) established in 1966.

The main objective of the Treaty is to provide macroeconomic stability and credibility required to sustain the fixed exchange rate of the common currency. To achieve this objective, the member countries share a common regional central bank established in 1972, the Bank of Central African States (Banque des Etats d'Afrique centrale - BEAC), with headquarters in Yaoundé, which issues the common currency, the CFA franc since 1972. Equatorial Guinea (a former Spanish colony) joined the BEAC in 1985. The BEAC and the regional banking Commission (Commission Bancaire en Afrique centrale - COBAC), a banking supervision agency established in 1990, are the principal bodies (see Box 6).

In 1993, members of Banque des États de l'Afrique Centrale (BEAC) ceased redeeming CFA franc notes issued by BEAC circulating outside their borders, and members of BCEAO suspended redemption of CFA franc notes issued by Banque des États de l'Afrique Centrale (BEAC) circulating in BCEAO countries. No coins have been issued for general circulation.

b) The legal basis of the EC Council Decision

The CFA agreements are intrinsically exchange-rate agreements, despite their budgetary (as opposed to monetary) underpinning in some respects: the arrangements establish a link between an African currency and the French franc (now the euro), while being based on budgetary commitments from the French Treasury in the form of a liquidity facility to the African regional central banks.

The CFA agreements were formalised under Community law on the basis of Art 111.3 EC. The choice of this legal basis was however disputed by France at the time, as it considered that the Banque de France, and

therefore the ESCB, was not at all involved in these agreements from a monetary point of view, and that the budgetary nature of the French commitment (Treasury) circumscribed the matter as a French domestic issue covered by Art 111.5 EC. The position of several Member States at the time was to ensure that possible macroeconomic imbalances in the CFA countries could not affect the functioning of the euro area and the stability of EMU. Others felt that France should not be allowed to monopolise its privileged relationships with so many African countries and therefore advocated the use of Art 111.1 EC (which requires unanimity voting of the euro area Member States) as the proper legal basis for the envisaged exchange rate agreements. Recourse to Art 111.1 EC would definitely have put an end to the French prerogatives in the management of the CFA agreements. A compromise was finally reached on the basis of Art 111.3 EC.

c) The content of the EC Council Decision

In November 1998, France was empowered¹⁵ by the EC Council to continue the CFA agreements. France and the African countries concerned retain the sole responsibility for the implementation of these agreements. However, France is obliged to keep the Commission, the ECB and the Economic and Financial Committee (EFC)¹⁶ informed on a regular basis about the state of implementation of the agreements.

Likewise the EFC must be informed prior to changes to the parity between the euro and the CFA franc or the Comorian franc (see infra). Before the replacement of the franc by the euro, the change in parity with the CFA franc was the outcome of consensus among all signatory countries to the exchange rate agreements, i.e. France and its African counterparts. Since the replacement of the French franc by the euro, the prior information by France of its counterparts within the euro area (through the EFC Committee) constitutes an additional requirement.

To the extent that the nature or the scope of the agreements is not changed, France may negotiate and conclude modifications to the agreements. However, the Commission, the ECB and the EFC must be informed in advance of any such changes.

A more significant EU involvement is necessary if France would want to modify the nature or the scope of the agreements. In this event France would need to act within a negotiation mandate to be adopted by the EC Council, on the basis of a recommendation from the Commission and after consulting the ECB (cfr Art 111.3 EC), i.e. within the limits of a clear and precise delegation of power from the EC Council.

With respect to the credit facility aiming at financing the possible current account deficits of the beneficiary countries, neither the Community nor

¹⁵ Council Decision of 23 November 1998 (98/683/EC), O.J. L320, 28.11.1998, pp. 58 and 59

¹⁶ The EFC or Economic and Financial Committee has been established under Art 114(2) EC which defines the tasks of this Committee and its composition. See also Council Decision of 21 December 1998 on the detailed provisions concerning the composition of the EFC (98/743/EC – O.J. L358, 31.12.1998, pp. 109 and 110) and Council Decision of 18 June 2003 on a revision of the Statutes of the EFC (2003/476/EC – O.J. L158, 27.6.2003, pp. 58-60)

Box 4 : The Institutions of the West African Monetary Union (Benin, Burkina Faso, Ivory Coast, Guinea Bissau, Mali, Niger, Senegal, Togo)

The Conference of the Heads of State, the Council of Ministers, the Commission of WAEMU and the Central Bank are the main organs of the West African Monetary Union.

1. *The Conference of the Heads of State*

It is the supreme body of the Union. It settles all issues which have not been agreed upon by unanimity at the Council of Ministers' level. The Conference decides by unanimity.

2. *The Council of Ministers*

It defines the monetary and credit policy of the Union with a view to maintaining the common currency and to financing the activity and development of the member states. It is allowed to modify the parity with the euro. Each member state is represented by two ministers and has a single vote. The Council adopts its decisions by unanimity. The international institutions' representatives may be invited in a consultative capacity, as well as representatives of France and of other countries with which a co-operation agreement exists.

3. *The Commission of WAEMU*

Established in 1995, it is the executive body of the WAEMU. It issues opinions and recommendations to the Conference and the Council. It is the guardian of the economic and monetary union. It contributes to macroeconomic surveillance.

4. *The Central Bank of the Western African States (BCEAO)*

The Central Bank has the exclusive power to issue the banknotes of the Union. It is allowed to rediscount short and medium-term papers (up to ten years) and is allowed to provide budgetary financing to the countries up to 20 % of their fiscal revenues of the previous year. It is the accountant of the states' treasuries and is allowed to manage the external debts of these states, if they agree.

The Governor is appointed by the Council of Ministers for six years. The two Deputy Governors are appointed by the Board for five years. They must be citizens of the member states.

The Board is composed of 18 members (two per member state + two from France). They are appointed by the Governments of the countries which participate in the management of the Bank (the eight member states plus France). It takes its decisions by simple majority, except for decisions related to:

- the general conditions for issuing the currency;
- the rediscount operations on public paper of up to ten years;
- the participation in the capital of financial institutions for development.

These decisions are adopted by a 6/7 majority.

The *national committees of credit* are composed of the Minister of Finance, the two Board members of the state concerned, four other members appointed by the Government and of a representative of France. It regulates at local level (national level) the credit distribution, as well as the volume of the monetary issuing. The accounts are verified by a *Commissioner* appointed by the Council of Ministers. France appoints a *second Commissioner*.

Box 5 : The Institutions of the Central African Monetary Union (Cameroon, Central African Republic, Chad, Congo, Equatorial Guinea, Gabon)

The implementation of the monetary co-operation between the Central African states has been attributed to a Conference of the Heads of State, a Ministerial Committee, the Executive Secretariat and the Bank of the Central African States (BEAC).

1. The Conference of the Heads of State

It is the supreme body of the Community and provides orientations to the Council of Ministers and Ministerial Committee (infra). It adopts its decisions by consensus.

2. The Council of Ministers and Ministerial Committee

It examines the broad orientations of the economic policies implemented by the member countries and ensures consistency with the common monetary policy. Each member state is represented by two ministers and has a single vote. The Council adopts its decisions by a 5/6 majority or by unanimity in certain areas (increase of the BEAC capital (see infra), an opinion on possible changes to the BEAC statutes, the adoption of the BEAC accounts and the sharing out of the latter's profits).

3. The Executive Secretariat

The Executive Secretariat is the guardian of the treaties. It coordinates the functioning of the different organs and institutions. It has a role of initiative and impulsion.

4. The Bank of the Central African states (BEAC)

Its functions and their modalities are comparable to those listed for the BCEAO. It is managed by a Board and national monetary committees. It is audited by a college of censors.

The Board is composed of 13 members appointed for a period of 3 years (4 members for Cameroon, 2 for Gabon, 1 for each other state and 3 for France). These members include the Finance Ministers of the African states concerned. The Board is responsible for defining monetary policy and giving directives to national committees. It adopts its decisions by simple majority, except for more important ones which are adopted by a majority of $\frac{3}{4}$ of the votes. The presence of a French representative is required.

The Governor and the Deputy Governor are appointed by the Board for 5 years. Their role is to implement the decisions of the Board.

The national monetary committees are composed of the Board members of the countries concerned or their substitute (as well as of three other members appointed by the Government). The Governor and two censors attend the meetings in a consultative capacity. They examine the financing needs of the country and define the necessary means to satisfy them. They in particular define the discount ceilings. Their decisions can be suspended and submitted to the Board by a censor.

The college of censors is composed of a censor from Cameroon, a censor of Gabon and a French censor. The college audits the bank accounts and verifies the regularity of its operations.

Box 6 : The CFA agreements as a multinational agency of restraint

As a result of the banking crisis in the CFA zone, new institutional arrangements were adopted following the Yammosoukro conference of 1990, including the centralization of responsibility for banking supervision in two regional banking control commissions: the Banking Commission of UEMOA and the Banking Commission of Central Africa (COBAC). This centralisation provides an additional multinational “agency of restraint” and fills a gap in the previous institutional arrangements. These Commissions are in charge of designing the prudential regulations applicable to banks and supervising banks through on-site and off-site inspections.

The Banking Commissions, chaired by the governors of the regional central banks, played a key role in the restructuring process carried out in the last decade. By setting up common prudential and accounting standards, the Commissions contributed to achieving a level playing field throughout the regional currency areas and to consolidating the solvency of both local and regional credit institutions, thus enhancing deposit security and access to credit. However, the degree of banks’ compliance with key prudential ratios varies across countries, pointing to a need for enhanced financial integration (Strauss-Kahn, 2003).

The model adopted in the CFA zone therefore diverges from that applied in EMU, which has left supervision of financial intermediaries as a national responsibility. The CFA arrangements make therefore wider use of monetary cooperation in establishing external discipline on national fiscal and financial policy than the EMU does (Honohan and Lane, 2001).

the ECB/ESCB can be expected to be involved or to provide financing. France alone is responsible for implementing these agreements, including its budgetary consequences. In this respect, France has moreover provided assurances that the budgetary impact of these agreements would be insignificant and that it would not affect its capacity to meet its obligations under the budgetary rules of the Community (Excessive Deficit Procedure as well as Stability and Growth Pact).

d) *The replacement of the French franc by the euro as the anchor currency*

The replacement of the French franc by the euro constitutes an opportunity for the African countries concerned to extend the benefits they have already gained from their monetary link with the French currency.

The euro indeed constitutes a more attractive external reference currency than any individual national European currency. It provides the opportunity to these African countries to gain wider access to the European single market. More generally, the increasing use of the single currency as the invoicing and settlement currency in international economic and financial relationships limits the exchange rate risks for the CFA countries. This further emphasizes the positive trend in trade, enabling the CFA area to take part in the benefits of monetary union in Europe (Kreditanstalt für Wiederaufbau, 1996).

Simultaneously, it constitutes a supplementary factor strengthening the need for adjustment in Africa. EMU constitutes an important example to

African countries and African trading zones, since it combines the independence of a system of central banks with a set of rules in favour of macroeconomic stability, freedom of trade and capital movements. In this respect, it offers many answers to the pressing questions faced by the African continent (Kreditanstalt für Wiederaufbau, 1996).

e) ***The potential effects of the CFA franc zone on EMU***

These agreements are not deemed to have any meaningful impact on the functioning of EMU. First of all, they do not create any obligation for the ECB or the ESCB to support the convertibility and/or parity of the CFA or Comorian franc. Moreover, the capacity of France to fulfil its obligations under Art 104 EC should not be affected, as the impact on the French budget is limited: in 1997 the CFA zone represented 2.9 % only of French GDP and less than 3 % of French M2 (1.4 % in 1991) (Diallo, 2002). On the other hand, the African countries are now compelled to apply macroeconomic policies similar to those applied in the euro area.

France continues to exert influence on the definition of monetary policy in the countries concerned, notably through its representation in the boards of the respective regional central banks. In particular, restrictive monetary measures, destined to restore equilibrium, are put in place whenever an imbalance occurs or develops on the operations accounts. France can also exert peer pressure at the annual meetings of the Finance Ministers (see Box 7).

As regards the convergence of economic policies, both sub-areas of the CFA franc zone implement a variant of the stability pact based on multilateral surveillance and macroeconomic benchmarks inspired by the ones applying in the euro area. The WAEMU introduced a Convergence Pact in December 1999 while the CAEMC adopted four convergence criteria in 2001 identical to the main four criteria of the WAEMU Pact: a zero or positive budget balance by 2002, a public debt/GDP ratio below 70%, overdue payments to be settled by 2002 for the WAEMU and by 2004 for the CAEMC, an inflation rate to be maintained below 3% per year. A commitment to medium-term stability programmes has reinforced the multilateral surveillance, notably through enhanced budgetary policy coordination, and has reinforced the credibility of the CFA-euro peg. In parallel, there has been a strong political will over recent years to foster regional integration. New institutions have been set up and regulations have been adopted, in particular to speed up the introduction of customs unions¹⁷ (Strauss Kahn, 2003).

¹⁷ “The customs union in the WAEMU has been in effect since January 2000, together with the introduction of a common external tariff and the removal of customs duties on intraregional trade. A similar process is ongoing in the CAEMC. In order to maximise the benefits of customs unions, both regions have pursued their efforts at tax harmonisation, leading to the introduction of a harmonised value added tax in each sub-area. In the legal field, business law is now governed by a common treaty, and the WAEMU and CAEMC countries have set up a Court of Justice in each sub-area. In addition, both monetary unions have set up regional exchange regulations that also support financial integration by lifting all restrictions on current transactions” (Strauss-Kahn, 2003).

Box 7 : The mechanisms of the CFA franc zone

Before organising their co-operation with France, the African States of the CFA zone concluded agreements reaffirming their solidarity links: in 1972 for Chad, Cameroun, Central African Republic, Congo and Gabon, in 1973 for Benin (Dahomey), Ivory Coast, Burkina Faso (Haute Volta), Niger, Senegal and Togo. Soon thereafter, these countries reaffirmed their willingness to continue their monetary cooperation with France within the CFA zone and defined its main principles:

- free transfers of current transactions and of capital, with a common exchange regulatory framework harmonised with France;
- unlimited convertibility of the currencies concerned;
- fixed parities;
- unlimited guarantee from the French Treasury for the currencies;
- pooling of the currency reserves (at least 65 %) in “operation accounts” managed by the French Treasury.

These “operation accounts” play a central role in the convertibility and the unlimited guarantee of the currencies provided by the French Treasury. The rules applying to these accounts are the following:

- the operation accounts are established in euro;
- the forex reserves of the countries concerned are transferred to these accounts, except for the working balances and the amounts related to transactions with the IMF;
- the French Treasury provides the necessary amounts which the regional central banks might need both for internal or external purposes;
- the operation accounts are allowed to be negative without any limit to the level of indebtedness;
- specific interest rates exist both for credit and debit situations;
- an exchange rate guarantee exists in case of a depreciation of the euro.

This implies that all monetary transfers from and to countries outside the CFA zone, i.e. the currency dealings, have to go through the operation accounts and are compulsorily handled/implemented at the Paris Stock Exchange.

The possibility for the African countries of having recourse to the unlimited guarantee from the French Treasury has however an exceptional character. This exceptional character is guaranteed by several safeguard measures, notably:

- when the ratio between the external assets and the current obligations has been lower than 20 % for three consecutive months, the central banks' boards are immediately seized to adopt the necessary decisions: raising the rediscount rate, lowering the rediscount or advances ceilings, reduction in the public financing;
- when the operation accounts evolve negatively and might become insufficient, the regional bank shall transfer the foreign exchange reserves accumulated by itself to these accounts. It shall also buy the forex exchange detained by both public and private organisms against CFA francs. It shall moreover invite member countries to use their IMF drawing rights;
- when the operation account of the BEAC is negative for three consecutive months, the rediscount ceilings and other short term facilities shall be reduced by 20% in the countries where the external accounts are negative and by 10 % when the external accounts are only slightly positive;
- the monetary financing which the regional central banks are allowed to provide to a particular state can not exceed 20% of the fiscal revenues of this state during the previous year.

f) The CFA franc zone and the concept of the Optimal Currency Area

The CFA franc zone has functioned properly in recent years. The regional central banks' objective of price stability has been achieved with an average inflation of 3% in both areas (WAEMU and CAEMC) from 1996 to 2001, compared to 15% for Africa as a whole. The participating countries have not experienced any exchange rate crises in recent years. This stability results from the cautious monetary policies conducted by the CFA franc zone central banks combined with the multilateral surveillance of national policies. Moreover, the implementation of monetary policy is decentralised to take account of the specific national economic features and facilitate the absorption of potential assymmetric shocks (Strauss-Kahn, 2003).

There appears to be a high degree of correlation between inflation shocks to different CFA members (less as regards Niger and Chad which both are Sahelian economies with very low industrial or mineral exports). If the policy response to inflation shocks is immediate, and inflation is the main concern, the cost of CFA membership to current members is unlikely to be large. With regard to shocks to output growth, there are two groups of countries¹⁸ within which output growth shocks are highly positively correlated, but between which output growth shocks are negatively correlated. The countries of the second group are all three (Ivory Coast, Mali and Congo Republic) highly indebted. However, if shocks to the CFA franc zone are not immediately offset by a monetary policy response then their effect will vary substantially across member states, with no obvious common policy response appropriate to all (Fielding and Shields, 2000).

Diverging climatic conditions, in particular in the Sahelian countries, and geographical or natural barriers make these countries heavily exposed to potential external assymmetric shocks. In addition, regional trade integration in Africa has been remarkably undeveloped. The pattern of African trade is largely external and many of the CFA franc zone countries have specialised in exporting raw commodities with a remarkable concentration in a handful of primary products (petroleum, fish, tobacco, coffee, cotton and cocoa), whose international market prices are especially volatile (Azam, 2003). But for all but four of the CFA countries, France, as the former colonial power, was still the largest source of imports in 2004, while the share of euro countries in African imports from the industrial world exceeds 1/3 in each African country. Globally, the euro area represents half of the foreign trade of the CFA franc zone countries. This points in the direction of the euro as the reference currency (Honohan and Lane, 2001).

Living standards are very heterogeneous, with GDP per capita ranging from a factor of one to 24. However, labour mobility is relatively significant and has benefited from the recent introduction of regional

¹⁸ The first group is composed of Benin, Burkina Faso, Senegal, Togo, Niger, Cameroon, Gabon, Central African Republic, Chad. The second group is composed of Ivory Coast, Mali and Congo Republic, which are all three highly indebted countries.

passports, even though poor transport infrastructures have hindered this development (Strauss-Kahn, 2003).

The still fragmented financial system of the CFA franc zone entails substantial inefficiencies and has a limited ability to act as a shock absorber. The establishment by the CFA countries in 1994 of a cross-country authority for the prudential regulation of banks, which distances the supervisors from improper pressures from politicians and other influential persons, is expected to enhance the effectiveness of banking supervision (Honohan and Lane, 2001).

The absence of any regional budget deprives the CFA countries from any fiscal adjustment mechanism at regional level (Strauss-Kahn, 2003). The survival of the franc zone may ultimately be based on the continuing flow of financial assistance to the CFA member countries from France. However, the use of the automatic overdraft facility enshrined in the CFA agreements was much smaller than the cumulative flow of other aid from France over the years. French banks are still the major source of financing for most of the former French colonies. On average, 60 % of public aid and 70 % of foreign direct investment in CFA countries originated from European countries in 1999 (UK included). It is interesting to note that the average share of financing in Africa coming from EU countries exceeds 80 % (mainly France, UK, Germany, Belgium, Austria, Italy, Spain and Portugal). This again points in the direction of the euro as the reference currency (Honohan and Lane, 2001).

g) *The devaluation of the CFA franc in 1994 (Honohan and Lane, 2001)*

Since the independence of most of the CFA countries in 1960, there has been a single devaluation vis-à-vis the French franc: by 50 % in January 1994 (see Box 8). This followed a long period of economic stagnation reflecting loss of price competitiveness, fiscal indiscipline, and banking collapse. Subsequent growth has been quite strong.

Box 8 : The successive parities of the CFA franc (WAEMU – CAEMC)

The successive parities of the CFA franc (WAEMU and CAEMC) have been the following:

1944: 1 CFA francs = 1 FF
1945: 1 CFA Franc = 1.7 FF
1948: 1 CFA francs = 2 FF
1960: 50 CFA francs = 1 FF
1994 (devaluation): 100 CFA francs = 1 FF
1999: 655,957 CFA francs = 1 euro

After 1985, the economic and financial situation of the CFA area deteriorated as a consequence of two major external shocks. The terms of trade of the zone deteriorated by about 50 % as a result of a sharp fall on the world markets in the prices of the major African export commodities.

The external competitiveness of the area was also affected by the marked appreciation of the French franc against the currencies of the CFA area's other major trading partners. Despite attempts at internal adjustment, a number of structural and sectoral rigidities (in particular on the labour market) worsened the situation, increasing public expenditure and the public sector financing requirements up to unsustainable levels (Kreditanstalt für Wiederaufbau, 1996). The ensuing public debt service crowded out both public and private investment and the wide recourse to public arrears suffocated many firms which then faced severe cash flow problems (Azam, 2003).

For years, the governments in several member states had directly or indirectly pushed banks into lending to state-owned enterprises, to regional and political groupings or to some of the governments' own suppliers who had not been paid. Over the years, the share of non-performing borrowers, including those who considered politically-driven loans as grants, grew. Widespread banking insolvency became apparent from mid-1980s. Sometimes, local commercial banks were partly French-based commercial banks, in which sometimes the French government was the majority shareholder, and in which wider interests than purely financial ones, including the commercial interests in Africa of their French customers, were pursued. The central banks, nominally independent, sometimes acted as agents of the fiscal authorities, refinancing politically inspired bank lending that could never be repaid. The rigidity of the framework for monetary and banking arrangements in the franc zone gave policy makers a false feeling of security. The consequence was a massive bank insolvency amounting to at least 10 % of the zone-wide GDP. The rigidity of the exchange rate peg eventually magnified the real economic effects of imprudent fiscal and financial policy (Honohan and Lane, 2001). The establishment of regional banking commissions in 1994 aims at preventing the repetition of such a situation in the future.

h) Recent macroeconomic developments in the CFA franc zone (Banque de France, 2005)

In 2004, the real GDP growth rate of the African franc area countries rose from 3.5 % in 2003 to 5.1 %, owing in particular to the boom of the oil industry in Equatorial Guinea and Chad. Nevertheless, excluding oil-related activities, economic growth in the CAEMC area (net oil exporter area) stood at 4.2 %, compared with 3.2 % in 2003. But real GDP growth in WAEMU countries stood at 2.8 %, down slightly from 2.9 % in 2003, as a result of adverse climatic conditions and locust invasions, while Ivory Coast was still affected by socio-political troubles. Therefore, with an investment rate far below the level observed for Africa as a whole, economic growth in the WAEMU countries was lower than in the whole Sub-Saharan Africa (5.1 %).

African franc area countries maintained a relatively stable macroeconomic framework. Inflation declined from 1.3 % in 2003 to 0.5 % in 2004 in the WAEMU countries and from 1.2 % to 0.3 % in the CAEMC countries (in sharp contrast with Sub-Saharan Africa, where the average inflation rate was 9.3 % in 2004). This very low inflation can be attributed to the

nominal pegging of the CFA franc to the euro, given that African franc area countries carried out almost half of their foreign trade with the low inflation euro area, while the appreciation of the euro lowered their import costs. Moreover, the franc area central banks implemented vigilant monetary policies, with money supply rises consistent with price stability. The foreign exchange reserves held by the central banks of African area countries continued to expand with external assets/money in circulation ratios of 117 % in WAEMU countries and 74 % in CAEMC countries.

The monetary authorities of both areas continued the phasing out of direct advances from the central banks to the States. The CAEMC countries registered a budget surplus of 4.4 %, while the budget deficit of the WAEMU area rose only moderately (from 2.1 % in 2003 to 2.6 % in 2004). But none of the CAEMC countries and only three WAEMU countries satisfied the four primary convergence criteria detailed supra under item e.

The current account deficit of the CAEMC countries narrowed substantially (from -8.4 % in 2003 to -3.7 % in 2004) in 2004 thanks to the improvement in the terms of trade following the rise in oil prices, while the deficit of WAEMU countries also fell, but moderately (from -4.1 % in 2003 to -3.5 % in 2004), thanks to the decline in interest paid on external debt and the growing weight of remittances from migrant workers.

These positive trends were expected to continue in 2005, despite a slower world economic growth.

4.2. *The Comoros Islands*

The Comoros are located in Southern Africa (Map 1). They form a group of four islands at the northern mouth of the Mozambique Channel, about two-thirds of the way between northern Madagascar and northern Mozambique. France colonized Mayotte in 1843. The Comoro Archipelago, which includes Mayotte, Anjouan, Grande Comore and Moheli, became a French protectorate in 1886. The Comoro Islands were granted internal autonomy in 1961. The four islands voted on independence in 1974, which was granted to three of them in 1975. Mayotte voted to remain a French overseas territory.

Box 9 : The successive parities of the Comoros CFA franc

The successive parities of the Comoros CFA franc have been the following:

From 1963: 50 CFA francs = 1 FF
1994 (devaluation): 75 CFA francs = 1 FF
1999: 491.96775 CFA francs = 1 euro

French francs were used in the Comoros from around 1908 until the introduction of the Madagascar franc by the Banque de Madagascar in 1925. When the Comoros gained its independence, it issued its own franc from the Institut d'Emission des Comores from 1976 until 1984, and from the Banque Centrale

des Comores (located in Moroni) from 1984 until today. In 1994, the Comoros franc was pegged to the French franc (see Box 9) and underwent a devaluation by 33 % against the French currency. France and the Comoros Federation participate on an equal footing in the Board of the Central Bank of Comoros, composed of 8 members.

4.3. *Cape Verde*

a) *Geographical and historical background*

Cape Verde is located in Western Africa (Map 1). It is a group of islands in the North Atlantic Ocean, west of Senegal. The Portuguese discovered, settled and colonized Cape Verde in 1462. Cape Verde became an overseas province in 1961. A 1974 coup eventually led to independence in 1975.

Portuguese Mil Reis circulated and the Banco Nacional Ultramarino issued banknotes in Mil Reis for Cape Verde until 1911 when the escudo was introduced in Portugal, and subsequently in Cape Verde in 1914. The currency reform of 1953 unified the Portuguese escudo and the currencies of the Portuguese colonies, establishing a true currency area modelled after the sterling area and French franc zone. After independence, the Cape Verde escudo, issued by the Banco de Cabo Verde, was introduced at par with the Portuguese escudo.

Box 10 : The successive parities of the Cape Verde escudo

The successive parities of the Cape Verde escudo have been the following:

From March 1977: float

March 1998: 0.50 Cape Verde escudo = 1 Portuguese escudo

End-March 1998: 0.55 Cape Verde escudo = 1 Portuguese escudo

January 1999: 110.27 Cape Verde escudo = 1 euro

In 1998, Portugal and the Cape Verde concluded an agreement on exchange rate matters ensuring the convertibility of their currencies at a fixed parity (see Box 10). On 21 December 1998, the Council took a similar decision based on Art 111.3 EC¹⁹ to the one adopted for the CFA and Comorian francs and allowed Portugal to continue its present agreement with Cape Verde following the substitution of the euro for the Portuguese escudo. In particular, this Council Decision ensured that the convertibility of the Cape Verde escudo into the Portuguese escudo at a fixed parity (ensured by aid of a limited credit facility provided by the Portuguese Government) would not be materially affected by the transition to the euro.

¹⁹ Council Decision of 21 December 1998 (98/744/EC), O.J. L 358, 31.12.1998, pp. 111 and 112.

b) The content and the functioning of the agreement with Cape Verde

Portugal and its former colony of Cape Verde have concluded an agreement on exchange rate cooperation (ERCA) from 1 July 1998 onwards, which is intended to ensure the convertibility of the Cape Verde escudo into the Portuguese escudo at a fixed parity through a limited credit facility provided by the Portuguese Government.

The Exchange Rate Cooperation Agreement (ERCA) concluded in 1998 is based on three elements:

- a Committee for the Exchange Rate Cooperation Agreement (COMERCA): a surveillance committee composed of representatives of the Central Banks and the relevant ministries (Foreign Affairs and Finance) of both countries;
- a Unit for Macroeconomic Surveillance (UMS): composed of experts from both countries and aiming at monitoring the implementation of the economic policy measures and at evaluating the fulfilment of the macroeconomic goals and exchange rate rules;
- a Credit Facility for the reinforcement, when necessary, of Cape Verde's foreign exchange reserves: it constitutes an annual up-front support to the estimated foreign exchange inflows and can be used for the financing of imports or external debt service payments. The Credit Facility is limited in size, since it has withdrawal (€ 5 million) and overall (€ 27.4 million) credit limits. It is also limited in time, given that it has to be repaid by the end of each calendar year. Up to now, the cumulated amount of disbursements under the Credit Facility has been € 54.9 million at a concessional interest rate of 0.5 % per year.

The exchange rate agreement (ERCA) aims at eliminating the exchange rate risk, not only for the transactions with Portugal, but also with the other euro area countries. The fixed parity between the Cape Verde escudo and the Portuguese escudo (i.e. now the euro) offers the possibility for Cape Verde of strengthening its economic relations with the euro area. The latter represents a significant share (see data in Annex 1) of Cape Verde's external trade, tourism receipts, and workers' remittances. The authorities of Cape Verde have committed themselves to follow a policy orientated towards macroeconomic stability, adopting the reference criteria followed by the EU Member States in the EMU context.

As in the case of the CFA agreements, the budgetary commitment of the Portuguese authorities towards Cape Verde does not entail any obligations for the Portuguese central bank, the ECB and the ESCB or for the Community. The Portuguese authorities have moreover provided assurances that the budgetary implications of the agreement would not affect its ability to comply with the Community obligations in budgetary matters (Excessive Deficit Procedure as well as Stability and Growth Pact).

The Portuguese authorities are required to keep the Commission, the EFC and the ECB informed of the implementation of the agreement. In

particular, they are requested to inform the EFC in advance of any possible changes in the parity between the euro and the Cape Verde escudo. Changes in the nature or the scope of this agreement would require the approval of the Council on the basis of a recommendation of the Commission, after consultation of the ECB.

c) ***Cape Verde and the concept of Optimal Currency Area***

Cape Verde runs a high trade deficit and is closely dependent on Portugal and the euro area for its external exchanges. Thanks to its peg to the euro, the country has experienced very low inflation rates in recent years. As already mentioned, the country benefits from a credit facility at concessional terms from Portugal.

5. Formal monetary agreements with third countries

The present section examines the monetary agreements which the Community has concluded under Art 111.3 EC with Vatican City State, Monaco and San Marino.

In a broader background of close economic and political ties resulting both from their geographical situation and their limited size, all three countries had concluded earlier monetary agreements with their neighbours France and Italy, respectively, prior to the signing of the Maastricht Treaty. In order to ensure continuity, the Conference at Maastricht indicated in Declaration No. 6²⁰ that the Community would facilitate the renegotiations of existing arrangements with the Vatican City, the Principality of Monaco and the Republic of San Marino, as might become necessary following the introduction of the single currency.

In order to enable the start of the negotiations on future monetary agreements with the Community replacing the existing conventions with the two Member States, the Council on 31 December 1998 adopted three decisions on the position to be taken by the Community regarding agreements concerning monetary relations with the Principality of Monaco (1999/96/EC)²¹, the Republic of San Marino (1999/97/EC)²² and Vatican City (1999/98/EC)²³. France and Italy were given respective mandates to negotiate and to conclude on behalf of the Community, while the Commission and the ECB were fully associated to the negotiations.

5.1. Geographical and historical background

a) Vatican City

The Vatican City State is an enclave in Rome. In the mid 19th century, many of the Papal States (which covered central Italy including Rome) were seized by the newly united Kingdom of Italy. The Papal States were further circumscribed when Rome itself was annexed in 1870. Disputes between “prisoner” popes and Italy were resolved in 1929 by three Lateran Treaties which established the independent state of Vatican City.

The monetary relations between Italy and the Vatican City were governed by a renewable ten year Monetary Convention, which was last renewed in December 1991. The Vatican used Italian banknotes, which circulated de facto in Vatican City without formal status. Since 1929, the Vatican issued its own lira coins (through the Banca d’Italia), which were also legal tender in Italy. The Italian lira coins were legal tender in Vatican City. Since Italy adopted the euro in 1999, the Holy See has also adopted the euro as its currency. Euro banknotes and coins, issued by the European

²⁰ “The conference agrees that the existing monetary relations between Italy and San Marino and the Vatican City and between France and Monaco remain unaffected by the Treaty establishing the European Community until the introduction of the ecu as the single currency of the Community. The Community undertakes to facilitate such renegotiations of existing arrangements as might become necessary as a result of the introduction of the ecu as a single currency”.

²¹ OJ L 30, 4.2.1999, pp. 31 and 32. see also OJ L 142, 31.5.2002, pp. 59-73, for the text of the agreement.

²² OJ L 30, 4.2.1999, pp. 33 and 34. see also OJ C 209, 27.7.2001, pp. 1-4, for the text of the agreement.

²³ OJ L 30, 4.2.1999, pp. 35 and 36. see also OJ C 299, 25.10.2001, pp. 1-4, for the text of the agreement, and OJ L 267, 17.10.2003, pp. 27 and 28 for Council Decision 2003/738/EC modifying the text of the agreement.

Central Bank, began circulating in 2002, and the lira ceased to be legal tender²⁴.

b) Monaco

The Principality of Monaco is (Map 2) bordering the Mediterranean Sea and the southern coast of France, near the border with Italy. The Principality of Monaco was founded in 1612 and became sovereign in 1688. Under the Franco-Monegasque treaty of 1861, Monaco went under French guardianship but continued to be independent.

Monaco has been part of the French monetary system throughout its existence. French francs have been legal tender in Monaco since 1925, though Monaco has issued some coins and emergency banknotes. The framework for the monetary relations between France and Monaco was covered by the Monegasque ordinance of 1925 which specified that the coins of the French State and the banknotes of the Banque de France are legal tender in the principality, just as the national currency. Monaco used French banknotes and coins, but issued its own franc coins with a certain ceiling. The latter had the same characteristics as French coins, but were legal tender only within the territory of Monaco. In 1945, it was agreed that exchange rate controls applying in France would apply in an identical fashion in Monaco. Euro banknotes and coins, issued by the European Central Bank, began circulating in Monaco in 2002 and replaced the French franc.

c) San Marino

The Republic of San Marino is (Map 2) an enclave in central Italy. According to legend, San Marino was founded in 301 and is the self-proclaimed “world’s oldest republic”.

Monetary links between Italy and San Marino were governed by the Friendship and Good-Neighbourship Convention signed in 1939, together with a series of succeeding ten-year Monetary Conventions, the last of which was signed in 1991. San Marino committed itself to adopt the Italian lira as legal tender and not to issue banknotes or any other means of payment. It used the Italian lira banknotes as legal tender. San Marino was however allowed to issue its own lira coins. The latter had equal standing with Italian coins as legal tender in Italian territory. Euro banknotes and coins, issued by the European Central Bank, began circulating in San Marino in 2002 and replaced the Italian lira.

The monetary Convention was complemented by a Financial and Foreign Exchange Convention, also signed in 1991, which focused on capital movements and relations between financial institutions. This Convention is still in force, even though it is being renegotiated in order to reflect the introduction of the euro in San Marino and Italy. The financial and foreign exchange convention covered a series of matters, relating to the absence of

²⁴ The Order of Malta issued coins until 1798 when the Papal States became part of the Roman Republic. It began issuing new coins for collectors in 1961. The issue is a symbolic coinage, which does not circulate as a medium of exchange, and whose proceeds are used to maintain the Order’s hospitals, clinics and leprosariums.

capital restrictions, the legal status of San Marinese residents, the translation into Sanmarinese legislation of all foreign exchange arrangements and safeguard clauses decided by the Italian authorities vis-à-vis third countries, the avoidance of unfair competition from Sanmarinese financial institutions in their relations with Italian citizens, the creation of an adequate system of supervision, the exchange of information on financial institutions, and the implementation of the necessary instruments to repress tax fraud and money laundering.

5.2. Main characteristics of the monetary agreements concluded with the Vatican, San Marino and Monaco (see also Annex 2)

a) Transposition of specific EC financial legislation and co-operation

The Vatican City, San Marino and Monaco undertook to make certain Community rules applicable to euro banknotes and coins. They also agreed to co-operate closely with the EC with regard to measures against the counterfeiting of euro banknotes and coins, and to suppress and punish any counterfeiting on their territory.

In the case of Monaco, the monetary agreement contains many additional elements, most of which already formed part of the earlier agreements with France. This was mainly due to the fact that the agreement is at the same time setting the terms and conditions for Monegasque banks to have access to EU payments systems and to Eurosystem monetary policy operations (see below). As a consequence, the relevant EU financial market legislation ensuring the protection and stability of the euro and the financial system needed to be extended to Monaco. At the same time, a level playing field is created by ensuring that the overall regulatory framework is broadly similar to the one applying to euro-area financial institutions.

The agreement with Monaco i.a. provides that the following EU legislation needs to be “transposed” in Monaco²⁵: monetary operations, minimum reserves, other monetary instruments, penalties/sanctions, statistics, credit institutions (activity, monitoring and prudential supervision thereof), investment services regulation, payment and settlement systems, prevention of systemic risks in the payment and settlement systems, as well as prevention and fight against fraud and money laundering.

²⁵ Transposition of specific EC financial legislation and co-operation in the agreement with Monaco:

- shall apply in Monaco: legal acts by the Council based on Article 107.6 EC or on Articles 5.4, 19.1, 34.3 of ESCB Statute - legal acts by the ECB based on the aforementioned legal acts or on Articles 5, 16, 18, 19, 20, 22 or 34.3 of the ESCB Statute - legal acts by the Banque de France implementing the aforementioned acts;
- Monaco applies measures adopted by France to adopt the Community acts listed in Annex A of the monetary agreement. These acts concern credit institutions as well as payment and securities settlement system, in particular prudential supervision of credit institutions and prevention of systemic risks to payment and securities settlement system (firstly, Monaco shall apply the provisions of the French Monetary and Financial Code concerning the activities and monitoring of credit institutions. It shall also implement regulations in accordance with the Franco-Monegasque agreement of 1945 concerning foreign exchange control and with the Franco-Monegasque Exchanges of Letters of 1963, 1987 and 2001 concerning banking regulations. Secondly, it shall apply the provisions of the French Monetary and Financial Code concerning the prevention of systemic risks to payment and securities settlement systems);
- Monaco adopts measures equivalent to the EC Member States to apply Community acts contained in Annex B of the monetary agreement. At present Annex B contains the EC Directive on investment compensation scheme only;
- Monaco takes measures having equivalent effect to Community directive on money laundering.

b) Access of financial institutions to the euro area payments system and to the Eurosystem monetary policy operations

As already mentioned, financial institutions located in Monaco have access to the payments and settlement systems of the euro area, as well as to the Eurosystem monetary policy operations. Financial institutions in Monaco are therefore subject (see *supra*) to virtually the same conditions as those applying to French institutions and to measures adopted by the Banque de France in implementing the ECB provisions laying down monetary policy instruments and procedures²⁶.

Financial institutions located in San Marino and the Vatican City may be granted access to payment systems within the euro area, subject to the conditions to be laid down in an agreement between Banca d'Italia and the ECB.

c) The issuance of euro coins

As from 1 January 2002 the three states may issue euro coins (not banknotes) for a certain maximum annual face value which is added to the volume of coins issued by Italy (for San Marino and Vatican City) and France (for Monaco) for the purpose of the ECB's approval of the total volume of the issue by these Member States in accordance with Article 106.2 EC²⁷. Euro coins issued by these states have the same specifications as those issued by the Member States and have legal tender status throughout the Community. This approach avoids possible confusion among EU citizens.

The euro coins of the three states are minted at the institutions in charge of minting the French and Italian euro coins. These states support the minting costs, but benefit from the seigniorage revenues.

The types of ceiling:

The ceilings for euro coins to be issued by the Vatican City State and by San Marino consist of fixed amounts to be issued each year: euro 2 million for San Marino and euro 1 million for the Vatican City State. The Vatican City State benefits from additional volumes in exceptional circumstances²⁸. These volumes are updated every two years to take account of the changes in Italy's consumer price index.

Monaco's ceiling consists of a fixed share of the French cumulative issue volume: issuance is defined as 1/500 of the quantity of coins issued by

²⁶ Similar provisions existed in the previous monetary arrangements between France and Monaco, whereby all credit institutions located in the Principality were treated like credit institutions located in France.

²⁷ "Member States may issue coins subject to approval by the ECB of the volume of the issue. The Council may, acting in accordance with the procedure referred to in Article 252 and after consulting the ECB, adopt measures to harmonise the denominations and technical specifications of all coins intended for circulation to the extent necessary to permit their smooth circulation within the Community."

²⁸ The Vatican City is allowed to issue an additional amount of euro 300.000 in cases of exceptional circumstances (Holy See vacancy, Holy Jubilee Year, opening of Ecumenical Council). This occurred in 2005 after the decease of Pope John Paul II: a limited quantity of "camerlengo" coins were issued, depicting the coat of arms of the Cardinal "Camerlengo", who is the acting head of state until the new pope is elected.

France in the year. Monaco's cumulative volume is equivalent to roughly euro 6 million at present²⁹.

The reason for the differences in the types of ceilings is historical: absolute amounts were used in the previous bilateral agreements with Italy, while the previous bilateral agreement between France and Monaco used a ratio of coin issuance.

The issuance of collector coins³⁰:

The three countries are allowed to issue euro collector coins up to a certain value. Monaco is allowed to issue collector coins denominated in euro only, while the other two states are moreover allowed to issue collector coins in another “currency” (gold collector coins in “scudi” for San Marino). There is no obligation for the Vatican City State to comply with the EC guidelines for collector coins not denominated in euro.

d) Additional provisions

The monetary agreement concluded with Monaco establishes a joint committee, meeting at least once a year, in order to monitor the implementation of the agreement, to examine equivalence of measures adopted by Monaco when implementing Community acts contained in Annex B of the agreement as well as to suggest possible amendments to the agreement.

5.3. The monetary agreements with the Vatican, San Marino and Monaco and the concept of Optimal Currency Area

Vatican (population of 921 inhabitants), San Marino (28,880 inhabitants) and Monaco (32,409 inhabitants) are very small states. This implies that the costs associated with having an autonomous currency are hardly justified (see our comments on the elimination of the transaction costs on page 14). Moreover, these three countries are, from an economic point of view, closely integrated with their neighbouring country.

Since the end of the second world war (1940-45), Monaco and San Marino have experienced an exceptional economic upturn thanks to positive developments in the banking sector and in tourism and they now belong to the richest countries in the world. PPP per capita in San Marino and Monaco have been high in recent years (see Annex 1), while unemployment rates have been very low. Public finances and inflation levels are comparable with those registered in the euro area. The balances of payments have been positive and have allowed the building up of net foreign assets (Winkler, Mazzafero, Nerlich and Thimann, 2004);

²⁹ The Monaco type of quota seems more in line with issue volume as its relative share of coins shall remain constant over time. Monaco's total/cumulated issue will rise only slightly in the future, after the substantial initial issue of 2002. Over time, the total amount of the euro coins issued by the Vatican and by San Marino will largely exceed the total issuance allowed to Monaco both in relative and absolute terms, and will represent a small but meaningful part of the total Italian quota.

³⁰ Collector coins are issued on special occasions (national events) and are denominated in values which are different from circulation coins. They are legal tender in the country of issuance only.

Labour mobility has been high but, given the excess demand, most often resulted in intrant flows from immediate neighbours. These states are very open economies with intense trade links with their immediate neighbours of the EU with whom they form a customs union. Off-shore banking and tourism activities have been the vectors of a very close integration of these microstates into their EU environment. For example, the banking customers in Monaco and San Marino have been non residents at respectively 90 % and 34 % in recent years (Winkler, Mazzafero, Nerlich and Thimann, 2004). Fiscal transfers are not provided for, but have not been necessary to maintain the sustainability of the euroisation.

6. The specific cases of Saint Pierre-et-Miquelon and Mayotte

On 31 December 1998, the EC Council adopted a Decision concerning monetary arrangements in the French territorial communities of Saint Pierre-et-Miquelon and Mayotte. Both Saint Pierre-et-Miquelon and Mayotte are overseas territories of France which do not form part of the Community and which used the French franc as legal tender.

6.1. Geographical and historical background

a) The Collectivité Terroriale Saint Pierre-et-Miquelon

The Collectivité Terroriale Saint Pierre-et-Miquelon is located in Northern North America (Map 3). It is an island in the North Atlantic Ocean, south of Newfoundland (Canada). Settled by the French in the early 17th century, Saint Pierre-et-Miquelon became a French colony in 1816, a French overseas territory in 1946, a French overseas department in 1976, and a French collectivité territoriale in 1985.

French francs became legal tender in Saint Pierre-et-Miquelon in 1839 and remained legal tender until 1942. In 1944, the privilege of banknote issue was transferred to the Caisse Centrale de la France d'Outre-Mer. Saint Pierre-et-Miquelon used the CFA franc from 1945 until 1972, when banknotes of the Caisse Centrale de la France d'Outre-Mer lost their legal tender status. In 1972, banknotes of the Banque de France began circulating in replacement of the CFA franc banknotes. Euro banknotes and coins, issued by the Eurosystem, began circulating in Saint Pierre-et-Miquelon in 2002 and the French franc ceased being legal tender. The Eurosystem's monetary regime and policies apply.

b) Mayotte

Mayotte is located in Southern Africa (Map 1). It is an island in the Mozambique Channel, about one-half of the distance from northern Madagascar to northern Mozambique. Mayotte was annexed by France in 1841 and officially ceded with the other islands of the Comoros in 1843. The Comoros gained autonomy in 1961 and the island of Mayotte voted against independence in 1974. When the Comoros declared independence in 1975, it thus remained part of France and became a French collectivité territoriale. In 2001, it became a departmental collectivity.

French francs were used in Mayotte until the introduction of the Madagascar franc in 1925. When the Comoros Islands became a separate French territory from Madagascar, the CFA franc replaced the Madagascar franc in 1946. Since Mayotte chose to become a French collectivité territoriale rather than becoming part of the independent Comoros, it began using French francs in 1976. France adopted the euro in 1999 and euro banknotes and coins were introduced in Mayotte in 2002. The Eurosystem's monetary regime and policies apply.

6.2. Content and functioning of the arrangement

The Collectivités Territoriales Saint Pierre-et-Miquelon and Mayotte used the French franc as their currency according to two French laws adopted in 1998³¹. In order to allow these territories to preserve the same currency as metropolitan France, the Council adopted a Decision in 1998 allowing France to grant legal tender status to euro banknotes and coins in Saint Pierre-et-Miquelon and Mayotte. It furthermore stipulates that France ensures that any relevant Community law is applied in the two territories concerned. The ECB and the Banque de France carry out the functions and operations of the ESCB³² (issuing euro banknotes, granting full access to the monetary policy operations and payment systems facilities of the ESCB, imposing minimum reserves, etc). Saint Pierre-et-Miquelon and Mayotte are part of France and, therefore, are not allowed to issue their own euro coins.

Council Decision of 31 December 1998 concerning the monetary arrangements in the French territorial communities of Saint Pierre-et-Miquelon and Mayotte (1999/95/EC - OJ L 30, 4.2.1999, pp. 29 and 30) was based on Art 123.4 EC³³. The third sentence of this article allows the Council at the starting date of the third stage of EMU to take all other measures necessary for the rapid introduction of the euro as the single currency of the EC Member States. But since both territories do not form part of the EU and are therefore third territories, the choice of this legal basis was not uncontroversial. In its Opinion (1999/C 127/06 O.J. C 127, 7.5.1999, p. 5) the ECB expressed the view that "*the very special case of the two French territorial communities should not create a precedent for other cases that may arise in the future.*"

The choice of this legal basis was influenced by the very specific circumstances of the run up to the euro in 1999 and was linked to the fact that these French overseas territories already used the French currency at the time. It therefore appeared appropriate to allow them to use the euro as their currency, as soon as the French franc was replaced by the euro.

6.3. The monetary arrangements with Saint Pierre-et-Miquelon and Mayotte and the concept of Optimal Currency Area

Saint Pierre-et-Miquelon's economy is based on fishing, while Mayotte's economy relies upon the cultivation of sugar can. Both territories are therefore vulnerable to asymmetric shocks. However, more than 60 % of Saint Pierre-et-Miquelon's external trade is conducted with euro-area Member States. Moreover, both territories, Mayotte in particular, run high trade deficits with

³¹ Law of 12 May 1998 modifying the statute of the Banque de France and Law of 2 July 1998 on several economic and financial provisions (DDOEF).

³² Until 31 December 1998, banks operating in Saint Pierre-et-Miquelon had access to refinancing facilities provided by the Institut d'Emission des Départements d'Outre Mer (IEDOM). The latter had not a status of a national central bank of the euro area. The status and role of the IEDOM was therefore reformed by France so as to make it compatible with the EC Treaty. Since then, the IEDOM plays the same role as before, but is now an agency of the Banque de France and thus part of the ESCB.

³³ Art 124.3 EC reads as follows: "*At the starting date of the third stage, the Council shall, acting with the unanimity of the Member States without a derogation, on a proposal from the Commission and after consulting the ECB, adopt the conversion rates at which their currencies shall be irrevocably fixed and at which irrevocably fixed rate the ecu shall be substituted for these currencies, and the ecu will become a currency in its own right. This measure shall by itself not modify the external value of the ecu. The Council, acting by a qualified majority of the said Member States, on a proposal from the Commission and after consulting the ECB, shall take the other measures necessary for the rapid introduction of the ecu as the single currency of those Member States.*"

France and their reference currency area. They are heavily dependent on extensive financial assistance from France: Mayotte received the equivalent of US\$ 107 million in 1997, while Saint Pierre-et-Miquelon receives approximately the equivalent of US\$ 65 million each year from France.

7. Third countries or territories using the euro de facto (not “de iure”)

Beside countries having concluded exchange-rate and monetary agreements with the Community, there are a few countries or territories using the euro de facto, i.e. without any agreement with the Community: Andorra, Montenegro and Kosovo.

7.1. Andorra

a) Geographical and historical background

The Principality of Andorra is located in South-western Europe (Map 2), between France and Spain. For 715 years, from 1278 to 1993, Andorrans lived under a unique co-principality, ruled by French and Spanish leaders (the Bishop of the diocese of Urgella - a Spanish city - and the President of the French Republic - both in their personal capacity - are the joint Heads of the Andorran State). The feudal system was terminated in 1993 when Andorra became a sovereign state, adopted a constitution and introduced parliamentary democracy. It does not form part of the Community.

Andorra never had either an official currency or any formal currency regime, although the two co-princes of Andorra have the customary power to mint coins. Andorra used two nominal currencies, the peseta tied to the Spanish peseta, and the Andorran diner tied to the French franc, although these currencies existed in name only. The government of Andorra issued emergency banknotes during the Spanish Civil War, although it has not issued any banknotes since then. Andorra also issued coins, denominated in pesetas, though mainly for numismatic purposes. In practice, French and Spanish banknotes and coins were traditionally used in parallel as quasi official currency, but did not have legal tender status. Andorra switched to the euro in 1999 along with France and Spain. On 11 October 2000, Andorra adopted a law officially introducing the euro and granting legal tender status to euro banknotes and coins unilaterally as from 1 January 2002 (ECB, 2005). In January 2002, French and Spanish banknotes and coins were replaced by euro notes and coins. In the Community's view, Andorra is therefore euroised de facto, but not de jure.

On 15 July 2003, the Andorran authorities formally requested the conclusion of a monetary agreement with the Community. Since a balanced monetary agreement with Andorra would offer benefits to both parties³⁴, the Council adopted in May 2004 a negotiation mandate³⁵ for a monetary agreement with this country, on the basis of a Commission Recommendation³⁶. The signing of an agreement with the Community (and its Member States) on the taxation of income from savings

³⁴ Andorra would indeed be able to adopt the euro as its official currency and could be allowed to mint certain quantities of euro circulation and/or collector coins. At the same time, the use of the euro in Andorra would be subject to a number of rules and a clear legal framework would thus be established. In addition, the monetary agreement would ensure co-operation with the Community in areas of particular importance (prevention of counterfeiting and money laundering) and ensure the application of certain relevant measures forming part of the Community's banking and financial regulation to the financial sector in Andorra. This would contribute to establishing broadly comparable conditions and hence a level playing field between financial institutions situated in the euro area and those located in Andorra.

³⁵ Council Decision 2002/548/EC, OJ L244, 16.7.2004, pp. 47-49.
³⁶ SEC(2004)204 final.

constituted an explicit condition. After the signature, the Council authorised in October 2004³⁷ the formal opening of negotiations on monetary matters with this country.

b) *Andorra and the concept of Optimal Currency Area (Winkler, Mazzafero, Nerlich and Thimann, 2004)*

The situation is quite similar to the one described for San Marino and Monaco. Tourism is a factor of integration. Andorra is indeed one of the most tourism-oriented countries, with overnight visitors per year corresponding to more than 4000 % of total population. Tourism and the hotel sector account for almost 35 % of total employment in Andorra. Andorra also benefits from a high degree of trade integration with its neighbours. The openness ratio (i.e. the sum of exports and imports divided by GDP) is equivalent to 100 %. Andorra's financial sector is another integration factor with its neighbours.

7.2. Montenegro

a) *Geographical and historical background*

Montenegro is located in South-eastern Europe (Map 2). The territory is bordering Bosnia and Herzegovina, Croatia and Albania, to the Southwest of Serbia and to the West of Kosovo. Montenegro became independent in 1878 and adopted its first constitution in 1905, but was united with Serbia in 1918. In 1992, after the breakup of Communist Yugoslavia and the introduction of a multi-party political system, it became part of the Serbian-Montenegrin Federal Republic of Yugoslavia. In 2003, after years of insistence from Montenegro, the Federal Republic of Yugoslavia was renamed into Serbia and Montenegro and reconstituted as a loose commonwealth. On 3 June 2006, the Parliament of Montenegro declared the independence of Montenegro, formally confirming the result of the referendum on independence of 21 May 2006.

(For the monetary history of Yugoslavia and Serbia, see infra under Kosovo) Montenegro currently has a different monetary system from Serbia and obtained autonomy over monetary and exchange-rate policies in the late nineties. On 2 November 1999³⁸, the Republic unilaterally introduced the D-mark as a parallel currency, along with the Yugoslav dinar, as a means to protect its economy from the inflationary policies of the National Bank of Yugoslavia. The D-mark already widely circulated in Montenegro and had traditionally been used as an unofficial means of payments, in particular for large transactions. After it became legal tender, the D-mark replaced the Yugoslav dinar almost completely. In 2000, the Law on the Central Bank of Montenegro was adopted and the D-mark/euro became sole legal tender in the Republic. In 2002, euro banknotes and coins began circulating in Montenegro.

³⁷ Council Decision 2004/750/EC, OJ L332, 6.11.2004, p. 15.

³⁸ The Decision of 2 November 1999 on introducing the German mark as legal tender in order to protect Montenegro's economic interests was adopted on the basis of Article 94, item 3, of the Constitution of the Republic of Montenegro.

b) Montenegro and the concept of Optimal Currency Area (Winkler, Mazzafaro, Nerlich and Thimann, 2004)

The disintegration of the Federal Republic of Yugoslavia is the original cause of euroisation. Euroisation was also aimed at establishing sound monetary foundations. After euroisation, inflation and interest rates declined, even though substantial inflation differentials to the reference currency area subsist. In comparison with Kosovo, the transition to a market economy has been more gradual, and growth more modest. Foreign aid has not been as sizeable, but has nevertheless been substantial: in 2002, foreign aid accounted for roughly 7.5 % of GDP and 12 % of total government revenues. But the government has been increasingly able to turn to domestic commercial banks. In 2002, tight fiscal policies and privatisation revenues led to a budget surplus.

Montenegro's financial sector has suffered from poor governance and bad lending. Since euroisation, banking sector reform has been high on the reform agenda. However, interest rates do not seem to follow those in the euro area, reflecting a higher insolvency risk. Financial integration can also be improved, since foreign participation in the banking sector has so far been negligible.

Factor mobility is high as a number of Montenegrins live and work abroad, mainly in the EU and Switzerland. Their remittances constitute an important source of income. The economy is highly open with an openness ratio equivalent to 100 %, but Montenegro also has a sizeable trade deficit (35 % of GDP) that is mainly financed by private and official transfers and by a surplus in the balance of services owing to tourism revenues. Trade is still focused on the neighbouring former Yugoslav Republics (45 % of total 2002 imports whereas Italy, Greece, Germany and Austria contributed about 24 %), while integration in the EU is limited. Montenegro's export industry is highly concentrated, with aluminium accounting for more than 60 % of total exports. Switzerland, Serbia and Kosovo are the major export destinations.

7.3. Kosovo

a) Geographical and historical background

Kosovo is located in south-eastern Europe (Map 2). This region is bordering Albania and FYROM to the South of Serbia and to the East of Montenegro. Following the First Balkan War of 1912, Kosovo became a part of Serbia. It became an autonomous province of Serbia in 1963 and gained virtual self-government in 1974. In 1992, the republics of Serbia and Montenegro declared a new "Federal Republic of Yugoslavia" in 1992 and led various military interventions to unite ethnic Serbs. In 1998-99, massive expulsions of ethnic Albanians living in Kosovo provoked an international response leading to the stationing of a NATO-led force in Kosovo. Although Kosovo is de jure part of the state union of Serbia and Montenegro, it is now de facto administered by the UN Interim

Administration Mission in Kosovo (UNMIK) since 1999, pending a determination by the international community of its future status³⁹.

Yugoslavia adopted the Serbian dinar as its single currency. The Yugoslav Federation dinar was introduced in 1945 after Yugoslavia's liberation. During the 1990s, Yugoslavia underwent one of the worst hyperinflations in human history, and several currencies successively replaced each other. In 2003, the parliaments of Serbia and Montenegro voted to change their name from Yugoslavia to Serbia and Montenegro, and the Serbian dinar replaced the Yugoslav dinar. Kosovo currently has a different monetary system from Serbia. The deutschmark (D-mark) was de facto used as currency, even before the 1999 war. On 4 October 1999, the UNMIK decided to choose the D-mark as the currency for Kosovo, informing the Deutsche Bundesbank about this step⁴⁰. Later, the UNMIK officially replaced the D-mark by the euro, informing the ECB about the step⁴¹. In 2002, euro cash began circulating in Kosovo. While the Serbian dinar remains an official currency, it is mainly used in the Kosovo Serb enclaves, and only sporadically outside of them. Most trade is conducted in euro, Kosovo's administration uses euro exclusively, and all commercial banks use the euro as the primary currency.

b) *Kosovo and the concept of Optimal Currency Area (Winkler, Mazzafero, Nerlich and Thimann, 2004)*

Strong support of the donor community for Kosovo, makes it difficult to come to any conclusion as regards the sustainability of euroisation (foreign aid and local spending by expatriates represent 33 % of the country's added value, while foreign remittances represent some 25-30 % of GDP). The causes of euroisation were political (disintegration of the Federal Republic of Yugoslavia). Euroisation also served the purpose of establishing sound monetary foundations for rebuilding the economy after civil war. After euroisation, inflation and interest rates declined. Inflation rates and deposit rates have now come close to euro area levels. Kosovo has experienced strong growth in recent years.

The case of euroisation is to some extent underpinned by factor mobility and the associated flows of remittances. A sizeable number of Kosovars live and work abroad, mainly in the EU and Switzerland. Official transfers have formed the backbone of Kosovo's reconstruction efforts, with 75 % of public spending in 2000/2001 being donor-financed, mainly by the EU. Euro area institutions and commercial banks have become majority shareholders of Kosovo's two largest banks. Kosovo's banks hold most of their liquid assets as deposits in euro area commercial banks.

More fundamental elements of integration are still underdeveloped and further progress in these areas will be of particular importance, particularly if foreign aid would start to dry up. The economy is highly open but its export activity is still negligible. Trade balance deficits were

³⁹ Under the authority of UN Security Council Resolution 1244 of 10 June 1999.

⁴⁰ Administrative Directive IUNMIK/DIR/1999/2 of 4 October 1999 implementing UNMIK Regulation N° 1999/4 of 2 September 1999 on the Currency Permitted to be Used in Kosovo.

⁴¹ Administrative Directive UNMIK/DIR/2001/24 of 21 December 2001 amending Administrative Directive N° 1999/2 implementing UNMIK Regulation N° 1999/4 on the Currency Permitted to be Used in Kosovo.

equivalent to 50 % of GDP. These deficits are covered by donor funds and remittances. Trade integration with the reference currency area is low, as the territory is still strongly linked to the economies of the former Yugoslav republics. Just 22 % of 2002 imports were from the EU and Switzerland, compared with a minimum of 40 % from former republics of Yugoslavia.

Annex 1: Overview of monetary and exchange-rate regimes relating to the Community or its Member States - Main statistical data

(Estimates based on several sources - mainly CIA Factbook - and related to various recent periods - most often indicated)

	Area (sq km)	Population (inhab.)	Median age (years)	PPP per capita (in US\$)	Inflation rate (%)	Unemployment rate (%)	Main export partner	Share (%)	€ share (%) based on main partners
									2005
									2004
EU	3.976.372	456.953.258	na	26.900	2,1	9,5	USA	22,9	-
Euro area	1.981.840	307.430.888	na		2,1	8,8	na	na	-

Participating Member States

	Area (sq km)	Population (inhab.)	Median age (years)	PPP per capita (in US\$)	Inflation rate (%)	Unemployment rate (%)	Main export partner	Share (%)	€ share (%) based on main partners
									2005
									2004
Belgium	30.528	10.364.388	40,6	30.600	1,9	12,0	Germany	19,9	54,1
Germany	357.021	82.431.390	42,2	28.700	1,6	10,6	France	10,2	39,8
Greece	131.940	10.668.354	40,5	21.300	2,9	10,0	Germany	13,3	27,7
Spain	504.782	40.341.462	39,5	23.300	3,2	10,4	France	19,3	49,7
France	547.030	60.656.178	38,9	28.700	2,3	10,1	Germany	15,0	40,6
Ireland	70.280	4.015.676	33,7	31.900	2,2	4,3	USA	20,2	37,1
Italy	301.230	58.103.033	41,8	27.700	2,3	8,6	Germany	13,7	33,1
Luxemburg	2.586	468.571	38,5	58.900	2,4	4,5	Germany	21,8	69,4
Netherlands	41.526	16.407.491	39,0	29.500	1,4	6,0	Germany	25,0	53,4
Austria	83.870	8.184.691	40,4	31.300	1,8	4,4	Germany	31,4	44,6
Portugal	92.391	10.566.212	38,2	17.900	2,1	6,5	Spain	24,8	60,7
Finland	338.145	5.223.442	41,0	29.000	0,7	8,9	Sweden	11,0	15,8
Total	1.981.840	307.430.888							

Annex 1: Overview of monetary and exchange-rate regimes relating to the Community or its Member States - Main statistical data (continued)
 (Estimates based on several sources - mainly CIA Factbook - and related to various recent periods - most often indicated)

ERM II Member States (situation as of mid-2005)

	Area (sq km)	Population (inhab.)	Median age (years)	PPP per capita (in US\$)	Inflation rate (%)	Unemployment rate (%)	Main export partner	Share (%)	€ share (%) based on main partners
									2004
Cyprus	9.250	780.133	34,7	20.300	2,4	3,2	UK	20,2	24,7
Denmark	43.094	5.432.335	39,5	32.200	1,4	6,2	Germany	16,9	27,2
Estonia	45.226	1.332.893	39,1	14.300	3,0	9,6	Finland	16,6	23,8
Latvia	64.589	2.290.237	39,1	11.500	6,0	8,8	UK	22,1	16,5
Lithuania	65.200	3.596.617	37,8	12.500	1,1	8,0	Switzerland	10,7	17,0
Malta	316	398.534	38,4	18.200	2,9	7,0	Singapore	15,5	19,5
Slovenia a	20.273	2.011.070	40,2	19.600	3,3	6,4	Germany	18,4	48,4
Total	238.698	15.061.686							

Other non participating Member States

	Area (sq km)	Population (inhab.)	Median age (years)	PPP per capita (in US\$)	Inflation rate (%)	Unemployment rate (%)	Main export partner	Share (%)	€ share (%) based on main partners
									2004
Czech Republic	78.866	10.241.138	39,0	16.800	3,2	10,6	Germany	36,2	42,3
Hungary	93.030	10.006.835	38,6	14.900	7,0	5,9	Germany	31,4	49,5
Poland	312.685	38.635.144	36,4	12.000	3,4	19,5	Germany	29,8	41,5
Slovakia	48.845	5.431.363	35,4	14.500	7,5	13,1	Germany	35,7	49,9
Sweden	449.964	9.001.774	40,6	28.400	0,7	5,6	USA	10,7	30,8
United Kingdom	244.820	60.441.457	39,0	29.600	1,4	4,8	USA	15,0	46,7
Northern Ireland	13.843	1.685.267	na	na	na	na	na	na	
Scotland	78.782	5.062.011	na	na	na	na	na	na	
Total	1.320.835	140.532.873							

Annex 1: Overview of monetary and exchange-rate regimes relating to the Community or its Member States - Main statistical data (continued)

Member States' territories which do not form part of the European Community

	Area (sq km)	Population (inhab.)	Median age (years)	PPP per capita (in US\$)	Inflation rate (%)	Unemployment rate (%)	Main export partner	Share (%)	€ share (%) based on main partners 2004
		2005	2005					2004	
Saint Pierre-et-Miquelon	242	7.012	33,7	7.000 (2001) (2003)	na	9,8 (1997)	Belgium	29,7	47,3
Mayotte	374	193.633	17,0	2.600 (2003)	na	38,0	France	80,0 (2000)	
New Caledonia	19.060	216.494	27,5	15.000 (2003)	-0,6 (2000)	19,0 (1996)	Japan	23,1	25,9
French Polynesia	4.167	270.485	27,5	17.500 (2003)	1,5 (2002)	11,8 (1994)	France	41,2	41,2
Wallis and Futuna	274	16.025	na	3.800 (2004)	na	na	Italy	40,0 (2003)	
Terres australes et antarctiques	7.829	145	-	-	-	-	-	-	
Tromelin	1	-	-	-	-	-	-	-	
Glorieuses	5	garrison/meteo	-	-	-	-	-	-	
Juan de Nova	4,4	garrison/meteo	-	-	-	-	-	-	
Europa	28	garrison/meteo	-	-	-	-	-	-	
Bassas da India	0,2	-	-	-	-	-	-	-	
The Netherlands Antilles	960	219.958	32,5	11.400 (2003)	2,1 (2003)	15,6 (2002)	US	27,3	4,3
Aruba	193	71.566	38,0	28.000 (2002)	3,2 (2002)	0,6 (2003)	US	79,9	4,3
Greenland	2.166.086	56.375	33,8	20.000 (2001)	1,6 (1999)	10,0 (2000)	Denmark	65,2	0,0
The Faroe Islands	1.399	46.962	35,1	22.000 (2001)	5,1 (1999)	1,0 (2000)	Denmark	38,6	0,0
British Indian Ocean Territory	60	-	-	-	-	-	-	-	
British Antarctic Territory	1.395.000	200	-	-	-	-	-	-	
Akrotiri	123	6.300	-	-	-	-	-	-	
Dhekelia	130	7.200	-	-	-	-	-	-	
The Falklands	12.173	2.967	na	25.000 (2002)	3,6 (1998)	0,0 (2001)	Spain	79,4	79,4
South Georgia and South Sandwich Islands	3.903	-	-	-	-	-	-	-	
Sint Helena	410	7.460	35,4	2.500 (1998)	3,2 incl.	14,0 (1998)	US	27,1	5,1
Ascension Island	incl.	incl.	incl.	incl.	incl.	incl.	incl.	incl.	
Tristan da Cunha	incl.	incl.	incl.	incl.	incl.	incl.	incl.	incl.	
Anguilla	102	13.254	30,8	7.500 (2002)	2,3	8,0 (2002)	UK	na	
Bermuda	53,3	65.365	39,8	36.000 (2003)	3,3	5,0 (2002)	France	73,8	73,8
British Virgin Islands	153	22.643	30,9	38.500 (2004)	2,5	3,0 (1995)	Virgin Islands (US)	na	
Cayman Islands	262	44.270	36,8	32.300 (2004)	2,8	4,1 (1997)	US	na	
Montserrat	102	9.341	28,6	3.400 (2002)	2,6	6,0 (1998)	US	na	
Pitcairn Islands	47	46	na	na	na	na	na	na	
Turks and Caicos Islands	430	20.556	27,4	11.500 (2002)	na	10,0 (1997)	US	na	

Annex 1: Overview of monetary and exchange-rate regimes relating to the Community or its Member States - Main statistical data (continued)
 (Estimates based on several sources - mainly CIA Factbook - and related to various recent periods - most often indicated)

Third countries with a formal monetary or exchange rate agreement with the Community or a Member State

	<i>Area (sq km)</i>	<i>Population (inhab.)</i>	<i>Median age (years)</i>	<i>PPP per capita (in US\$)</i>	<i>Inflation rate (%)</i>	<i>Unemployment rate (%)</i>	<i>Main export partner</i>	<i>Share (%)</i>	<i>€ share (%) based on main partners 2004</i>
		2005	2005	2004	2004			2003	
<u>Monetary agreements</u>									
Vatican City	0.44	921	na	na	na	na	na	na	
Principality of Monaco	1.95	32.409	45,3	27.000 (2000)	1,9 (2000)	2,2 (1999)	France	na	
Republic of San Marino	61.2	28.880	40,3	34.600 (2001)	3,3 (2001)	2,6 (2001)	Italy	na	
<u>Exchange rate agreements</u>									
UEMAO - WAEMU									
Bénin	112.620	7.460.025	16,6	1.200	2,8	na	China	30,2	0,0
Burkina Faso	274.200	13.925.313	16,8	1.200	2,4	na	China	32,3	0,0
Guinea-Bissau	36.120	1.416.027	19,0	700	4,0 (2002)	na	India	54,9	4,1
Ivory Coast	322.460	17.298.040	19,1	1.500	1,4	13 (in urban areas) (1998)	US	11,3	33,8
Mali	1.240.000	12.291.529	16,4	900	4,5 (2002)	14,6 (in urban areas) (2001)	China	32,0	12,8
Niger	1.267.000	11.665.937	16,3	900	3,0 (2002)	na	France	47,1	47,1
Senegal	196.190	11.126.832	18,2	1.700	0,8	48,0 (2001)	India	13,8	20,6
Togo	56.785	5.681.519	17,8	1.600	1,0	na	Burkina Faso	16,0	6,6
CEMAC - CAEMC									
Cameroon	475.440	16.380.005	18,6	1.900	1,0	30,0 (2001)	Spain	16,2	45,6
Central African Repu	622.984	3.799.897	18,1	1.100	3,6 (2001)	8,0 (2001)	Belgium	41,0	64,7
Chad	1.284.000	9.826.419	16,0	1.600	8,0	na	US	74,2	5,2
Congo	342.000	3.039.126	20,7	800	1,8	na	China	30,8	0,0
Equatorial Guinea	28.051	535.881	18,8	2.700 (2002)	8,5	30,0 (1998)	US	34,0	21,1
Gabon	267.667	1.389.201	18,6	5.900	1,5	21,0 (1997)	US	51,9	7,7
Comores	2.170	671.247	18,6	700 (2002)	3,5 (2001)	20,0 (1996)	US	42,2	18,0
Cape Verde	4.033	418.224	19,4	1.400 (2002)	1,5	21,0 (2000)	Portugal	62,5	62,5
Total		6.531.720	116.987.432						

Annex 1: Overview of monetary and exchange-rate regimes relating to the Community or its Member States - Main statistical data (continued)
 (Estimates based on several sources - mainly CIA Factbook - and related to various recent periods - most often indicated)

Third countries or territories using de facto the euro or the currency of a non-participating Member State

	<i>Population Area (sq km)</i>	<i>Median age (inhab.)</i>	<i>PPP per capita (years)</i>	<i>Inflation rate (in US\$)</i>	<i>Unemployment (%)</i>	<i>Main export partner</i>	<i>Share (%)</i>	<i>€ share (%) based on main partners</i>
	2005		2005					
Andorra	468	70.549	40,3	26.800 (2003)	4,3 (2000)	0,0 (1996)	Spain	58,0 (2000)
Kosovo	10.887	2.022.000	na	2.712	11,1	na	na	na
Montenegro	13.938	658.000	na	na	na	na	na	na
Bailiwick of Guernsey	78	65.228	41,0	40.000 (2003)	4,9 (2004)	0,5 (1999)	UK	na
Bailiwick of Jersey	116	90.812	40,9	40.000 (2003)	5,3 (2004)	0,9 (2004)	UK	na
The Isle of Man	572	75.049	39,5	28.500 (2003)	3,6 (2003)	0,6 (2004)	UK	na
Total	26.059	2.981.638						

Currency boards

	<i>Population Area (sq km)</i>	<i>Median age (inhab.)</i>	<i>PPP per capita (years)</i>	<i>Inflation rate (in US\$)</i>	<i>Unemployment (%)</i>	<i>Main export partner</i>	<i>Share (%)</i>	<i>€ share (%) based on main figures</i>
	2005		2005					
Bosnia-Herzegovina	51.129	4.025.476	36,2	6.500	1,1	44,0 (off. - 20 % act.)	Italy	22,9
Bulgaria	110.910	7.450.349	40,7	8.200	6,1	12,7	Italy	13,2
Total	162.039	11.475.825						

ANNEX 2: Main Provisions of the monetary agreements with Vatican City, San Marino and Monaco

	Vatican City	San Marino	Monaco
Status of euro	<ul style="list-style-type: none"> - official currency - legal tender status granted to all euro banknotes and coins 	<ul style="list-style-type: none"> - official currency - legal tender status granted to all euro banknotes and coins 	<ul style="list-style-type: none"> - official currency - legal tender status granted to all euro banknotes and coins
Issuance of Euro coins or banknotes	<ul style="list-style-type: none"> - shall not issue any banknotes, coins or monetary surrogates of any kind unless condition agreed with Community - may issue euro coins for a maximum annual face value of EUR 1 000 000; added to the volume of coins issued by Italy for the ECB's approval of volume - may issue additional euro coins in the year the vacancy of the Holy See occurs, in each Holy Jubilee Year and the year opening Ecumenical Council (EUR 300 000 on each occasion) - Vatican City euro coins have to be identical to those issued by Member States of the EC (face value, legal tender status, technical characteristics, artistic features of common side and shared artistic features of the national side) 	<ul style="list-style-type: none"> - shall not issue any banknotes, coins or monetary surrogates of any kind unless condition agreed with Community - may issue euro coins for a maximum annual face value of EUR 1 944 000; added to the volume of coins issued by Italy for the ECB's approval of volume - San Marino euro coins have to be identical to those issued by Member States of the EC (face value, legal tender status, technical characteristics, artistic features of common side and shared artistic features of the national side) 	<ul style="list-style-type: none"> - shall not issue any banknotes; shall only issue coins after agreement with Community on conditions - may issue euro coins for a maximum annual volume of 1/500th of the quantity of coins minted by France; added to the volume of coins issued by France for the ECB's approval of volume - Monaco euro coins have to be identical to those issued by Member States of the EC (face value, legal tender status, technical characteristics, artistic features of common side and shared artistic features of the national side)
Collector coins	<ul style="list-style-type: none"> - agreement does not prejudge right to mint collector coins - euro collector coins included in the annual face value - euro collector coins shall be in accordance with guidelines laid down for collector coins - not legal tender in the EC 	<ul style="list-style-type: none"> - may issue euro collector coins and gold coins denominated in scudi - euro collector coins included in the annual face value - euro collector coins shall be in accordance with guidelines laid down for collector coins issued by Member States - euro collector coins and gold coins in Scudi not legal tender in the EC 	<ul style="list-style-type: none"> - may issue euro collector coins only - euro collector coins included in the annual face value - euro collector coins shall be in accordance with guidelines laid down for collector coins issued by Member States - not legal tender in the EC

	Vatican City	San Marino	Monaco
Community legislation and cooperation	<ul style="list-style-type: none"> - undertakes to make Community rules applicable on euro banknotes and coins - shall cooperate closely with EC with regard to measures against counterfeiting of euro banknotes and coins and to suppress and punish any counterfeiting in its territory 	<ul style="list-style-type: none"> - undertakes to make Community rules applicable on euro banknotes and coins - shall cooperate closely with EC with regard to measures against counterfeiting of euro banknotes and coins and to suppress and punish any counterfeiting in its territory 	<ul style="list-style-type: none"> - undertakes to make Community rules applicable on euro banknotes and coins - shall cooperate closely with EC with regard to measures against counterfeiting of euro banknotes and coins and to suppress and punish any counterfeiting in its territory - Legal acts by the Council based on Article 107(6) EC, Articles 5.4, 19.1, 34.3 of ESCB Statute and legal acts by the ECB based on the aforementioned legal acts or Articles 5, 16, 18, 19, 20, 22 or 34.3 of the ESCB Statute or by the Banque de France implementing such acts shall apply in Monaco - shall apply measures adopted by France to adopt the Community acts listed in Annex A concerning credit institutions and payment and securities settlement system - shall adopt measures equivalent to Member States' to apply Community acts contained in Annex B (at present only Directive on investment compensation scheme) - will take measures having equivalent effect to Community directive on ... money laundering
Access of Financial Institutions to payments system in the euro area	<ul style="list-style-type: none"> - may have access under appropriate terms and conditions determined by Banca d'Italia with agreement of the ECB 	<ul style="list-style-type: none"> - may have access under appropriate terms and conditions determined by Banca d'Italia with agreement of the ECB 	<ul style="list-style-type: none"> - access to payment and securities settlement systems - access to the Eurosystem's monetary policy operations - financial institutions subject to the same conditions as for those located in France and measures adopted by the Banque de France in implementation of ECB provisions laying down monetary policy instruments and procedures - subject to sanctions and disciplinary proceedings

	Vatican City	San Marino	Monaco
Additional Provisions			<ul style="list-style-type: none"> - establishment of a joint committee (representatives of Monaco, France, Commission and ECB) - shall exchange views and information - responsible for examination of equivalence of measures taken by Monaco and by Member States in application of Community acts contained in Annex B - revision of agreement
Amendments and Termination of agreement	<ul style="list-style-type: none"> - revision every 2 years of volume of coins issued by competent Italian financial bodies and Vatican City - each party and body participating in procedure to conclusion of agreement may request a review - each party may withdraw by one year's notice 	<ul style="list-style-type: none"> - revision every 2 years of volume of coins issued by competent Italian financial bodies and Vatican City - each party and body participating in procedure to conclusion of agreement may request a review - each party may withdraw by one year's notice 	<ul style="list-style-type: none"> - revision every 2 years by joint committee - parties may request amendments whenever necessary - each party may terminate with one year's notice

ANNEX 3

Situation in Member States' overseas entities which form part of the European Community:

With the exception of Gibraltar, Member States' overseas entities are located outside Europe.

1. Entities of participating Member States

The euro was introduced in all participating Member States' entities forming part of the European Community including those located overseas i.e. located geographically outside Europe. Article 299 of the Treaty on the European Community specifies the applicability of the Treaty with reference to the territorial sovereignty according to both the rules of international law and constitutional law of the Member State in question.

The euro was thus introduced in the French overseas departments (Guiana, Guadeloupe, Martinique, Réunion), the nine islands of the Azores, the three Madeira islands, the seven Canaric Islands as well as in Ceuta and Melilla, under the same conditions as in metropolitan France, Portugal and Spain.

French Guiana

French Guiana is located in Northern South America (Map 4), bordering the North Atlantic Ocean, between Brazil and Suriname. It was settled by the French in 1604. French Guiana has been a French Colony since 1674. It was part of Guadeloupe until 1820 and has been a French overseas department since 1946.

The Livre Coloniale was used in French Guiana until it was abolished in 1820. French francs have been legal tender since that date. The Banque de la Guyane began issuing the Franc Guiana in 1851. All monies of Metropolitan France were granted legal tender status in 1920. In 1944, the privilege of banknote issue was transferred to the Caisse Centrale de la France d'Outre-Mer. When the Nouveau franc was introduced in 1960, the Caisse Centrale began to issue the French Antilles Metropolitan franc for Guadeloupe, Guyane and Martinique. From 1975, banknotes of the Banque de France began circulating in place of the French Antilles banknotes. When France joined the euro area in 1999, this naturally included French Guiana and the three other DOMs which form part of the Community. Euro banknotes and coins began circulating in French Guiana, Guadeloupe, Martinique and Reunion in 2002.

Guadeloupe

Guadeloupe is composed of eight islands: Basse-Terre, Grande-Terre, La Désirade, les Saintes, Marie-Galante, Saint Barthélémy and Saint Martin⁴². It is located between the Caribbean Sea and the North Atlantic Ocean, southeast of Puerto Rico (Map 4). La Guadeloupe became a French Colony in 1635 and a French Overseas department in 1946. On 7 December 2003, Saint Martin opted for becoming a French Collectivité d'Outre-Mer under Article 74 of the French Constitution (see in Annex 4): the Organic Law is currently submitted to the French Parliament for adoption.

The Livre Coloniale was used in Guadeloupe until it was abolished in 1820. French francs have been legal tender in French Guiana since 1820. The Banque de la Guyane began issuing the Guadeloupe Franc in 1851. See above under Guiana.

⁴² The island of Saint Martin is shared with the Netherlands: its southern half is named Sint Maarten and is part of the Netherlands Antilles (see infra).

Martinique

La Martinique is a Caribbean island (Map 4) located between the Caribbean Sea and the North Atlantic Ocean, north of Trinidad and Tobago. La Martinique became a French colony in 1635, and a French overseas department in 1946. It was periodically occupied by Britain between 1762 and 1814.

La Livre Coloniale was used in Martinique until it was abolished in 1820. French francs have been legal tender since 1820. The Banque de la Martinique began issuing the Martinique Franc in 1851 at par with the French Franc Germinal. See above under Guiana.

Reunion

La Reunion is a Southern African island (Map 5) located in the Indian Ocean, east of Madagascar. The French East India Company settled the island, then known as the Ile de Bourbon, in 1642. The Ile de Bourbon was captured by the British in 1810 but returned to France in 1815. It officially became known as Reunion in 1848, and was a French colony until it became a French overseas department in 1946.

Money issued by the Compagnie Française des Indes was used in Reunion from 1719 until 1766 when royal banknotes replaced the paper money of the Compagnie Française des Indes. In 1803, the new governor withdrew government notes. The Franc Germinal was introduced into France and its colonies by a law of 1803, but the Livre Coloniale was not officially abolished until 1820. French francs became legal tender in Reunion in 1820 and were the primary medium of exchange. Several local banks also issued banknotes periodically. The Banque de la Réunion was established in 1851, and it began issuing the Réunion Franc Germinal in 1873. Foreign coins were demonetized in 1879, and all monies of Metropolitan France were given legal tender status in 1920. In 1944, the privilege of banknote issue was transferred to the Caisse Centrale de la France d'Outre-Mer, and the CFA Franc Germinal became the currency in Reunion. Reunion left the CFA franc zone in 1959. The Reunion franc was reformed with a Decree of 1964 setting the Reunion franc Nouveau at par with the French franc Nouveau. From 1975, banknotes of Metropolitan France, i.e. of the Banque de France began circulating in replacement of Reunion banknotes. Euro banknotes and coins, issued by the Eurosystem, began circulating in Reunion in 2002, and the French franc ceased to be legal tender after the period of dual circulation.

The nine islands of the Azores

The Azores are a group of islands off the coast of Portugal (Corvo, Faial, Flores, Graciosa, Pico, Santa Maria, Sao Jorge, Sao Miguel, Terceira), including Angra, Horta and Ponta Delgada. This group of islands is located in the middle of the North Atlantic Ocean (Map 3) approximately 1500 km from the European coast and 3900 km from the North American coast. The Azores were discovered around 1427 by the Portuguese navigator Diago de Silves. The islands were subject to Spanish rule from 1580 until 1640 and turned to Portugal after 1640. The Azores have been an autonomous region within Portugal since 1976.

Portuguese milreis were used in the Azores until 1911 when the escudo replaced the milreis. Some provincial coins and banknotes were issued by the Banco de Portugal for the islands before the introduction of the Escudo in 1911. The Azores, as part of Portugal, joined the euro area in 1999. Euro banknotes and coins were introduced in 2002, and Portuguese escudos ceased to be legal tender the same year. The Banco de Portugal issued banknotes from 1847 until 2002, when the Eurosystem began issuing banknotes.

Under the terms of a specific Protocol attached to the Maastricht Treaty, Portugal was authorised to maintain the facility provided to the autonomous regions of the Azores and Madeira to benefit from an interest free credit facility with the Banco de Portugal under the terms established by existing Portuguese law. Portugal committed itself to pursue its best endeavours in order to put an end to the abovementioned facility as soon as possible and actually abrogated it in 1998 (Law n°13/98 Art 48)

with the closure of the current accounts of Azores and Madeira with the Banco de Portugal and respective debt amounts settlement by 31 December 2000.

The three Madeira Islands

The islands (mainly Madeira and Porto Santo) are located in the Atlantic Ocean (Map 1), about 360 miles directly west of Morocco, Africa, and 540 miles southwest of Lisbon, Portugal. The Madeira Islands form part of Portugal.

The Madeira Islands issued some local coins and currency, denominated in milreis during the 1800s, but since 1910 Portuguese escudos have been used exclusively on the Madeira Islands. The Madeira Islands continue to issue some coins, but for numismatic purposes only. Portugal introduced the euro in 1999 and euro coins and banknotes began circulating in 2002.

The seven Canary Islands

The seven islands (El Hierro, Fuerteventura, Gran Canaria, La Palma, La Gomera, Lanzarote and Tenerife) lie in the Atlantic Ocean (Map 1) about 95 km from the northwest coast of Africa. The Canaries were declared a province of Spain in 1821.

The Canary Islands follow the Spanish monetary and currency regime.

Ceuta and Melilla

Ceuta is a Spanish enclave in North Africa, located on the northernmost tip of Morocco on the Mediterranean coast near the straits of Gibraltar (Maps 1 and 2). Ceuta's strategic location has made it the crucial waypoint of many a culture's trade and military ventures. Ceuta was taken by the Portuguese in 1415 and ceded to Spain in 1668. Ceuta is known officially in Spanish as the Autonomous City of Ceuta, having a status between a normal Spanish city and an autonomous community. Before the Statute of Autonomy, Ceuta was administratively part of the Cádiz province. It does not form part of the customs territory of the European Union. The city is a free port.

Mellila is a Spanish autonomous city on the coast of eastern Morocco, in North Africa (Maps 1 and 2). Mellila was on the frontier of the Kingdom of Tremecen and the Kingdom of Fez when Spain conquered it in 1497. Mellila is an integral part of the Spanish state. It has been administered as part of Malaga province prior to the 1995 Statute of Autonomy. It is a free port.

Ceuta and Mellila follow the Spanish monetary and currency regime.⁴³

2. Entities of non-participating Member States

Gibraltar

Gibraltar is located on the southern coast of Spain (Map 2), bordering the strait of Gibraltar, which links the Mediterranean Sea and the North Atlantic Ocean. Gibraltar was ceded by Spain to Britain in 1713 (Treaty of Utrecht) and became a British crown colony in 1830. In 1967, Gibraltar voted in favour of remaining under British rule, and it has had general internal autonomy since 1969. Gibraltar entered the European Community, at the same time as the accession of the United

⁴³ Islas Chafarinas East of Melilla off north Moroccan coast, Penon de Alhucemas in the middle of the north Moroccan coast, Penon de velez de la Gomera in the middle of the north Moroccan coast, west of Penon de Alhucemas are three uninhabited islands, but are part of Spain, and if they used a currency, it would be the euro.

Kingdom. It is among the European territories for whose external relations a Member State is responsible under Article 299.4 of the EC Treaty (see annex 6). Article 28 of the Act concerning the Conditions of Accession and the Adjustments to the Treaties (which concerns the accession of the UK, Denmark and Ireland) provides that there shall be certain exceptions from Community measures with respect to Gibraltar (the Common Agricultural Policy, Value Added Tax and Common Customs Tariff do not apply). Subject to these explicit exceptions, all legislation adopted by the Community since 1973 has been applicable to Gibraltar.

In 1927, Gibraltar introduced a currency board to back its own banknotes. Since then, the local authorities have issued banknotes denominated in the local Gibraltar pound which is in a monetary union and at par with the British pound sterling. These banknotes are issued in conformity with local statutes and are legal tender in that territory, in parallel with the UK pound sterling. Gibraltar presently uses British coins, but with a specific reverse side. It not only issues coins and banknotes for local circulation, but also a large number of coins for numismatic purposes.

ANNEX 4

Situation in Member States' territories which do not form part of the European Community

The Member States' territories considered hereunder do not form part of the Community territory in the meaning of Article 299 of the EC Treaty⁴⁴. In principle, Member States retain their sovereignty with respect to currency matters as regards those territories, i.e. they are legally in the same position as a third country (vis-à-vis the Community) when acting on behalf of these territories.

All Member States' overseas entities which form part of the Community adopt the euro, as soon as the MS concerned decides to join the euro area. This is not the case for Member States' territories which do not form part of the Community, the so-called overseas countries and territories (OCTs). There is no official policy of the Community in this respect at the present stage.

1. Territories of participating Member States

As far as the participating Member States are concerned, only France and the Netherlands have genuine OCTs or overseas territories outside the Community:

a) France

i) Euro is used as currency (see Saint Pierre-et-Miquelon and Mayotte on pages 37-38)

ii) Currency linked to the euro

The French Collectivités d'Outre-Mer (New Caledonia, French Polynesia, Wallis and Futuna Islands) have the CFP franc as their currency. The CFP franc was pegged to the French franc in the past and is currently linked to the euro. In accordance with Protocol (No. 13) to the EC Treaty⁴⁵ and⁴⁶, France keeps the privilege of monetary emission in its overseas territories under the terms established by its national laws, and is solely entitled to determine the parity of the CFP franc. It has therefore the freedom to change the parity of the CFP franc to the euro, without involving the Community. The parity with the euro is currently guaranteed by the French Treasury at a rate of 1000 CFP franc for 8.38 euros.

The French Pacific Collectivities benefit from a status of far-reaching autonomy: the French State has most often residual competences only. The external (balance of payments) flows are mainly oriented towards France and the euro zone, notably as regards imports and financial flows. In particular, public transfers from France are sizable (approximately 20 % of local GDP and 50-55 % of imports) and are necessary to guarantee the main macroeconomic balances.

⁴⁴ These EU Member States territories, which are neither independent states nor part of the Community, enjoy a special association status, defined in Part Four of the EC Treaty. This special status is aimed at fostering the economic and social development of these territories as well as at strengthening the economic relations between them and the Community.

⁴⁵ "The High Contracting Parties, desiring to take into account a particular point relating to France, have agreed upon the following provisions, which shall be annexed to the Treaty establishing the European Community: 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."

⁴⁶ No specific decision from the Council was necessary, contrary to what happened in the cases of the exchange rate agreements with the CFA countries and Cape Verde.

Box 11 : Institut d'Emission des Départements d'Outre-Mer et Institut d'Emission d'Outre-Mer

IEDOM

In the four French Overseas Departments (Guadeloupe, French Guyana, Martinique, Réunion) as well as in Saint Pierre-et-Miquelon the issuing of currency was formerly assigned to a specific institution, the Issuing Institution of the Overseas Department or Institut d'Emission des Départements d'Outre-Mer (IEDOM), a national and public organism established in 1959 and located in Paris which acted as a correspondent of the Banque de France. The Institut ceased to issue banknotes in 1975.

France modified the status and role of the IEDOM in 2000 (Ordonnance du 19 avril 2000), so as to ensure the compatibility of this institution with the EC Treaty, by making it an agency of the Banque de France. The IEDOM now acts on behalf, for and under the authority of the Banque de France. In this framework, the IEDOM is now allowed to perform the Eurosystem tasks in these Overseas Departments and Territories (ECB, 2006).

IEOM

The Institut d'Emission d'Outre-Mer (IEOM) is the issuing institution for the three overseas territories: New Caledonia, French Polynesia, Wallis and Futuna. Like the IEDOM, it is a public institution of the French Republic with its own legal personality and financial autonomy. While the IEOM has no financial link with the Banque de France or the ESCB, the Banque de France's Governor is Chairman of the supervisory board of the IEOM (ECB, 2006).

The IEOM took over the right to issue banknotes from the Banque d'Indochine in 1969. The IEOM ensures the issuing of the currency which has legal tender in the overseas territories, i.e. the CFP franc of which the French State ensures the convertibility at a fixed rate of 1000 CFP francs for 8.38 euros. In the past, it issued separate, overprinted banknotes for French Polynesia (Papeete), the New Caledonia (Noumea) and the New Hebrides (Nouvelle Hebrides) until 1985, and began issuing a single series of banknotes for French Polynesia in 1985. The notes overprinted Papeete and Noumea are still valid. But banknotes are now identical for the three territories. Coins are differentiated for French Polynesia and New Caledonia. There are 4 different banknote denominations (ranging from 10.000 to 500 CFP francs) and 7 coin denominations (ranging from 100 to 1 CFP francs).

New Caledonia

New Caledonia is located in Oceania (Map 6). It is an island in the South Pacific Ocean, east of Australia. It includes the Loyautés Islands. New Caledonia was settled by both Britain and France during the first half of the 19th century. It became a French colony in 1853 and a French overseas territory in 1946. Since the adoption of the constitutional Law of July 1998 and of the organic Law of March 1999, New Caledonia is no longer a "Territoire d'Outre Mer", but benefits from a specific status called "Collectivité sui generis of the French Republic" and from a definitive transfer of competences from the State. It implies that New Caledonia now has true legislative powers, notably in fiscal matters.

Upon making New Caledonia a colony, the French introduced the French franc. The Banque de la Nouvelle-Calédonie was created in 1874 and issued banknotes in New Caledonia, although the Banque d'Indochine took over the responsibility for issuing banknotes in New Caledonia in 1888.

In 1920, all banknotes and divisionary coins of Metropolitan France became legal tender in New Caledonia. The New Caledonia franc traded at par with the French franc before World War II, but in 1941, New Caledonia was incorporated into the Sterling area. Consequently, the New Caledonia franc did not depreciate at the same rate as the French franc. The Colonies Françaises du Pacifique (CFP) Franc was created in 1945 for use in New Caledonia, French Polynesia and the Wallis and Futuna Islands. Because France had suffered inflation during the war, the initial exchange rate was set at 1 CFP franc equal to 2.4 French francs, but by 1949, the exchange rate had sunk. When France introduced the nouveau franc in 1960, a new CFP franc was not introduced, and the exchange rate was established at 1 CFP franc for 0.055 francs nouveaux.

French Polynesia

French Polynesia is located in Oceania (Map 7). It is an archipelago in the South Pacific Ocean, about halfway between South America and Australia. The French annexed various Polynesian island groups during the 19th century. French Oceania included the islands of Society (of which Tahiti is the largest), Marqueses Islands, Tuamotu, Tubuai, Borabora, Ra'iataea, Taha'a, Huahine and others. The island group became an overseas territory in 1946 and was formally named French Polynesia in 1957. Under Art 74 of the French Constitution, French Polynesia is now a “Collectivité d'Outre Mer” of the French Republic. In January 2004, its autonomy has been reinforced by two organic laws attributing it a status of “Pays d'Outre Mer”, i.e. a status comparable to the one of New Caledonia, whose competences are now very close to those of an entity composing a federal state.

Coins of Metropolitan France were first authorized for use in 1848. The Banque d'Indochine gained the right to issue notes in 1888. Since then, French Polynesia has followed the monetary history of New Caledonia (see above).

Wallis and Futuna Islands

Wallis and Futuna are Oceanian islands (Map 6) in the South Pacific Ocean, about two-thirds of the way from Hawaii to New Zealand. Although discovered by the Dutch and the British in the 17th and 18th centuries, the French declared a protectorate over the islands in 1842. In 1961, Uvea (Wallis) and Futuna became the French Overseas Territory of the Wallis and Futuna Islands. A Law of 1961 restrictively enumerates the French State's competences.

The Wallis and Futuna Islands have followed the same monetary history as New Caledonia (see above).

b) The Netherlands

i) Non euro-based currencies

The overseas territories of the Netherlands, i.e. the Netherlands Antilles and Aruba, benefit from a regime of far reaching autonomy. In particular, monetary and exchange rate policy matters are governed by their own laws. Their central banks issue the Antillean and the Aruban guilder. Both currencies are pegged to the US dollar.

The Netherlands Antilles

The Netherlands Antilles represent two island groups in the Caribbean Sea (Map 4) – one includes Curacao and Bonaire north of Venezuela; the other is east of the Virgin Islands. Aruba, Bonaire, Curacao (Leeward Islands), Saba, Sint Eustatius, the Dutch half of Sint Maarten (Windward Islands) and Dutch Guiana (Suriname) were united to form the Dutch West Indies in 1828. The islands (excluding Dutch Guiana) were united as the Netherlands Antilles in 1848. The Netherlands Antilles were the Dutch colony of Curacao, which became autonomous within the Netherlands in 1948. In 1954, the Netherlands Antilles gained the status of an overseas territory of the

Netherlands, with complete domestic autonomy. Aruba became a separate territory within the Kingdom of the Netherlands in 1986 (see below)⁴⁷.

The Dutch introduced the Guilder (also known as the Gulden or the Florin) in 1828. The Netherlands Antilles broke their link to the Netherlands Guilder in 1940 after Germany invaded the Netherlands, linking the Netherlands Antilles Guilder to the U.S. Dollar. The Curacaosche Bank issued banknotes for the Netherlands Antilles from 1855 until 1961, and the Bank van de Nederlandse Antillen has issued banknotes since 1955. The Government issued some Montbiljetten between 1955 and 1970.

Aruba

Aruba is a Caribbean island in the Caribbean Sea (Map 4), north of Venezuela. Aruba was discovered and claimed for Spain in 1499. Aruba became a Dutch colony in 1634, and was made part of the Dutch West Indies beginning in 1828 and part of the Netherlands Antilles (which excluded Suriname) beginning in 1848. Aruba became a separate territory within the Kingdom of the Netherlands in 1986.

The Dutch introduced the Guilder, in the 1700s. The Netherlands decimalized the Gulden in 1825. The Netherlands Antilles broke their link to the Netherlands Guilder in 1940 after Germany invaded the Netherlands, linking the Netherlands Antilles Guilder to the U.S. Dollar. After gaining independence within the Kingdom of the Netherlands, Aruba began issuing its own currency, the Aruba Guilder.

2. Territories of non-participating Member States

Denmark and the United Kingdom have overseas entities that do not form part of the Community and which either use the currency of their mother country (Greenland and the British Indian Ocean Territories) or use a domestic currency which is closely linked to the currency of their mother country (the Faroe Islands, the Falklands, South Georgia and the South Sandwich Islands, Sint Helena and its dependencies, the Ascension Island as well as Tristan da Cunha). Others use a domestic currency which is not formally linked to the currency of their mother country or linked to the currency of a third country. A few directly use the US dollar. Should Denmark and the United Kingdom join the euro area, monetary or exchange agreements would need to be considered for some of them.

a) Denmark

Both Greenland and the Faroe Islands are autonomous regions within the Kingdom of Denmark and do not belong to the Community⁴⁸. Protocol (Nr 8) annexed to the Maastricht Treaty⁴⁹ provides that the National Bank of Denmark will continue to carry out its existing tasks with respect to these territories.

i) Danish Krone used as currency

⁴⁷ In the course of 2004 and 2005, the five Netherlands Antilles islands carried out non-binding referenda on their future relations with the Netherlands:

- In May 2000, Sint Maarten voted in favour of a Status Aparte, i.e. a status comparable to the one existing for Aruba: a separate territory within the Kingdom of the Netherlands;
- In late 2004, Bonaire and Saba voted in favour of becoming full and integral parts of the Netherlands and hence abandoning their special status;
- In April 2005, Curacao voted in favour of becoming an autonomous state;
- In April 2005, Sint Eustatius voted in favour of maintaining the status quo, i.e. its current special status, which would mean to remain part of the Netherlands Antilles.

⁴⁸ Unlike the Faroe Islands, Greenland has the status of overseas country and territory associated with the Community (see Annex II to the EC Treaty).

⁴⁹ “The High Contracting Parties, desiring to settle certain particular problems relating to Denmark, have agreed upon the following provisions, which shall be annexed to the Treaty establishing the European Community: the provisions of Article 14 of the Protocol on the Statute of the European System of Central Banks and of the European Central Bank shall 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”.

Greenland

Greenland is located in Northern North America (Map 3). It is an island between the Arctic Ocean and the North Atlantic Ocean, northeast of Canada. Denmark held claim over Greenland, inheriting the Norwegian claim over Greenland that went back to 1261. Greenland became part of the Kingdom of Denmark in 1953, and gained autonomy in 1979. The responsibility for foreign policy, defence matters and monetary policy however remains with Denmark. Following the introduction of the home rule in Greenland and a local referendum in 1979, Greenland withdrew from the EC in 1985.

Greenland has used Danish coins and currency as legal tender since 1721. The krone existed as a unit of account as early as 1618. The Rigsdaler Courant became the principal coin of the realm in the 1700s, though there were several monetary systems based on the Rigsdaler. After 1813, the Rigsbankdaler was used. Denmark joined the Scandinavian Monetary Union in 1873, and the Norwegian and Swedish coins became legal tender in Denmark until 1914. Denmark reintroduced the krone during the currency reform of 1873. The Danish Administration in Greenland issued rigsdaler banknotes in 1803 and 1804, Rigsbankdaler banknotes between 1819 and 1873, and Kroner banknotes between 1873 and 1967 when Greenland ceased issuing its own banknotes. The close monetary links between Denmark and the home rule authorities in Greenland is now covered in Act n° 577 of 1978. Danish notes and coins circulate as sole legal tender in Greenland, which constitutes an integral part of the Danish currency area. Banks in Greenland and Danish banks have the same access to the Danish central bank as regards transactions in deposits, repos, etc and are under the supervision of the Danish Financial Supervisory Authority.

ii) Danish Krone-denominated currency

The Faeroe Islands

The Faeroe Islands are located in Northern Europe (Map 2). They are an island group between the Norwegian Sea and the North Atlantic Ocean, about one-half of the way from Iceland to Norway. The dynastic union between the Faeroe Islands and Denmark was established in 1380, although the Faeroe Islands were considered a Norwegian sideland. Transfer to Denmark took place gradually, and the Faeroe Islands gained self-government in 1948. The Faeroe Islands are now a largely autonomous part of Denmark.

(For information on the monetary history of Denmark, please see above under Greenland.) The monetary links between Denmark and the Faeroe Islands are specified in Act n° 137 of 1948 on home rule and Act n° 248 of 1948 concerning notes in the Faeroe Islands. The Faeroe Islands rejoined the Danish currency area in 1948, and an Act of 1949 allowed the Faeroe Islands to issue their own kronur banknotes through the Landsbanki Foeroya. The Faeroe Islands are subject to Danish currency legislation. The authority to issue banknotes in the Faroe Islands rests with the Danish Prime Minister and is exercised in cooperation with the local government. The currency is in a currency board regime with the Danish krona and the issued banknotes are fully covered as well as exchangeable at par and free of charge on a special account with the Danish NCB. Banks in the Faeroe Islands and Danish banks have the same access to the Danish central bank as regards transactions in deposits, repos, etc Faroese banks are under supervision of the Danish Financial Supervisory Authority. Under the Act on Faeroese Banknotes, these notes must have the same face value and dimensions as Denmark's banknotes. Banknotes in Faroese krone are printed by Denmark's National bank. The Faeroe Islands continue to use Danish coins and Danish kronen remain legal tender in the Faeroe Islands, in parallel with the Faroese krone banknotes.

b) United Kingdom

The UK has a number of overseas territories which do not form part of the Community. Most have a considerable level of self-government.

The UK pound sterling is legal tender in the British Indian Ocean Territories, while the Cyprus pound is used in the UK's Sovereign base areas in Cyprus (Akrotiri and Dhekelia). A sterling-denominated currency is issued by the Falklands (Falkland Pound), St Helena and its dependencies Ascension Island (St Helena Pound) and Tristan Da Cunha (Tristan Pound). As for most of UK's colonies in the past, the currencies of those territories are in a more or less orthodox currency board regime and at par with the British pound sterling⁵⁰. Other UK overseas territories either issue a non sterling denominated currency (their own currency) or use a non-EU currency: Anguilla (using the East Caribbean dollar), Bermuda (Bermuda dollar), British Virgin Islands (USD is sole legal tender; GBP and East Caribbean dollar also circulate), Cayman Islands (Cayman Islands dollar), Montserrat (East Caribbean dollar), Pitcairn Islands (New Zealand dollar), Turks and Caicos Islands (USD).

i) UK pound sterling is used as currency

A single British OCT (a military base) has the UK pound sterling as official currency.

The British Indian Ocean Territories

The British Indian Ocean Territories are an archipelago (Chagos Archipelago) in the Indian Ocean (Map 5), south of India, about halfway between Africa and Indonesia. The largest and most southerly of the islands is Diego Garcia. All others are uninhabited. The British Indian Ocean Territories were established from parts of the Outer Seychelles and Mauritius in 1965. In 1976, the former Seychelles territories were returned to Seychelles. Mauritius and its territories gained independence in 1968. The BIOT now comprise the six atolls of the Chagos Archipelago with about 56 individual islands in the Indian Ocean. Diego Garcia is the site of a joint UK-US military facility.

Although the British pound sterling is the official currency, US dollars are used more often than not.

ii) Cyprus Pound is used as currency

Two other British OCTs use the Cyprus pound as currency. Both are military bases.

Akrotiri and Dekhelia

Akrotiri is a peninsula on the southwest coast of Cyprus (Map 2). Dekhelia is located on the southeast coast of Cyprus, near Famagusta. Under the terms of the 1960 Treaty of Establishment that created the independent Republic of Cyprus, the UK retained full sovereignty and jurisdiction over two areas representing almost 254 sq km in total: Akrotiri and Dhekelia.

The Cyprus pound is used in Akrotiri and in Dekhelia.

iii) Sterling-denominated currency

The Falklands (Falkland pound), St Helena and its dependencies Ascension Island (St Helena pound) and Tristan Da Cunha (Tristan pound) have currencies which are British pound based.

The Falklands

⁵⁰ The British colonies had a currency board arrangement, with the colonial currency rigidly pegged to, and more or less, fully backed, by the pound sterling, but with seigniorage revenues accruing to the colonial administration by virtue of the interest earned on investment of the reserves in British Government securities (Honohan and Lane, 2001).

The Falklands islands are located in Southern South America (Map 8), more specifically in the South Atlantic Ocean, east of Southern Argentina. The first settlement was established by the French in 1764. The colony was turned over to Spain in 1766, prior to occupation by the British in 1833. The Falkland Islands became a British colony in 1892. After a territorial dispute between Britain and Spain, sovereignty is currently disputed by Argentina, which refers to them as the Islas Malvinas.

The Falkland Island pound currency area includes East and West Falkland, South Georgia, and the South Sandwich Islands. The government of the Falkland Islands began issuing banknotes in 1899, using a currency board to back the banknotes, and began issuing coins in 1974. A Currency Ordinance ensuring parity with the UK pound exists in the Falklands since 1987. British coins and currency are also legal tender within the Falkland Islands in parallel with the local Falkland pound.

South Georgia and South Sandwich Islands

South Georgia and the South Sandwich Islands are located in Southern South America (Map 8), more precisely in the South Atlantic Ocean, east of the tip of South America. The South Georgia and Sandwich Islands were claimed by Britain in 1775 and made a dependency of the Falkland Islands in 1908. The South Orkneys, South Shetlands and Graham Land were also Falkland dependencies from 1908 until 1962, at which moment they were made part of the British Antarctic Territory, and became a separate British territory in 1985.

South Georgia, and the South Sandwich Islands use the Falkland Island Pound as currency.

Saint Helena

Saint Helena is an island in South Atlantic Ocean (Map 1), about midway between South America and Africa. It was discovered in 1502 and in 1659 the British East India Company took possession of it as a stop in the route between Europe and the East Indies. It was again under British control between October 1815 and June 1821 when Napoleon was exiled on the island, and was reverted to the British East India Company in 1821. It became a British Crown Colony in 1834 and lost its importance when the Suez Canal was opened in 1869.

The British pound sterling became legal tender in 1843, and South African Pounds were legal tender from 1925 (under the St. Helena Coinage Order of 1925) to 1949. Saint Helena used the British pound until 1971. The Currency Fund Ordinance was passed in 1975 allowing the government of Saint Helena to issue Saint Helena pound banknotes and coins and ensuring parity with the UK pound. The Currency Regulations of 1976 established a currency board for Saint Helena (other sources mention that a currency board regime had already been established in 1917). Saint Helena also uses the British pound sterling. Local pounds and the pound sterling are both legal tender.

Ascension Island and Tristan da Cunha

The Ascension and Tristan da Cunha islands are located in the South Atlantic Ocean (Map 1), about midway between South America and Africa (see Saint Helena). Ascension was discovered in 1501, became a British possession in 1822, and was made a dependency of Saint Helena in 1922. It was administered by the Eastern Telegraph Company (now Cable and Wireless) until 1964.

Tristan da Cunha was discovered by the Portuguese with the same name in 1506, settled by Americans in 1810 and annexed by Great Britain in 1816. The island was made a dependency of Saint Helena in 1938.

The Saint Helena pound (see above under Saint Helena) is also used in Ascension and in Tristan da Cunha. Ascension and Tristan da Cunha have issued coins, mainly for numismatic purposes, but not banknotes.

iv) Non pound based currencies

Other UK overseas territories such as Anguilla, Bermuda, British Virgin Islands, Cayman Islands, Montserrat, Pitcairn Islands, Turks and Caicos Islands have a currency which is no longer Pound based.

Anguilla

Anguilla is a Caribbean island (Map 4) located between the Caribbean Sea and the North Atlantic Ocean, east of Puerto Rico. Colonized by English settlers from Saint Kitts in 1650, Anguilla was administered by Great Britain until the early 19th century. Anguilla was part of a single British dependency St. Kitts-Nevis-Anguilla from 1882. In 1971, two years after a revolt, Anguilla was allowed to secede. This arrangement was formally recognized in 1980, with Anguilla becoming a separate self-governing dependency of the United Kingdom.

United States dollars and British pounds sterling circulated in Anguilla until the creation of the British West Indies Dollar in 1935. In 1951, the Board of Commissioners of Currency, British Caribbean Territories (Eastern Group) became the sole note-issuing authority for the British West Indies dollar. The East Caribbean dollar, issued by the East Caribbean Currency Authority (see Box 12), replaced the British West Indies dollar in 1965. Anguillan notes have the letter U placed on them. Anguilla has issued coins for numismatic purposes, but not for general circulation.

Bermuda

Bermuda is located in North America (Map 4). It is a group of islands in the North Atlantic Ocean, east of South Carolina. Bermuda was first settled in 1609 by shipwrecked English colonists heading to Virginia. It became a British crown colony in 1684 and achieved representative government in 1968.

Pound sterling coins were first issued for Bermuda in 1793, and banknotes were issued for Bermuda beginning in 1914, though British Canadian and US currency also circulated. The Bermuda dollar was introduced in 1970 with 1 Bermuda pound equal to 2.4 Bermuda dollars equal to 2.4 US dollars. Bermuda has used a currency board since 1915. Banknotes were issued by the Government of Bermuda until 1974, and subsequently by the Bermuda Monetary Authority.

Box 12: The Eastern Caribbean Currency Union (ECCU)

The Eastern Caribbean Currency Union (ECCU) was formed when the Eastern Caribbean Central Bank (ECCB) was created. The governments participating in the East Caribbean Currency Authority (ECCA) signed the Eastern Caribbean Central Bank Agreement Act in 1983 to establish the ECCB. In accordance with this Agreement, the ECCB was formally established the same year, while the ECCA ceased to exist. Effective from this date, all the assets and liabilities of the ECCA, together with all its rights and obligations that are not inconsistent with the provisions of this Agreement, were transferred to the ECCB.

The ECCB is the monetary authority for the governments of Anguilla, Antigua and Barbuda, Dominica, Grenada, Montserrat, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines. The ECCB is governed by two acts: the Eastern Caribbean Central Bank Agreement of 1983 which establishes and defines the powers and operations of the ECCB and the Uniform Banking Act of 1993 which defines the operations of financial institutions within the ECCU area including their relations with the ECCB. The Monetary Council, which constitutes the governing body of the ECCB, comprises the Finance Minister of each of the eight members. The core purposes of the ECCB are to regulate the availability of money and credit, promote and maintain monetary stability, promote credit and exchange conditions and a sound financial structure conducive to the balanced growth and development of the territories of the participating governments, and actively promote the economic development of the territories of the participating governments.

The ECCB issues and manages a common currency for the area, the Eastern Caribbean dollar, with a fixed exchange rate pegged to the US dollar since July 1976. The peg takes the form of a currency board. The ECCB has the sole right to issue notes and coins for its member countries. The ECCB serves as a banker to its participating governments as well as to the commercial banks operating in the area. Governments maintain accounts with the ECCB through which transactions are conducted. Commercial banks maintain accounts with the ECCB to satisfy legal reserve requirements, to facilitate interbank transactions, and as a means of holding excess funds. The ECCB may grant advances to commercial banks to meet short-term liquidity needs. (IMF, 2005)

British Virgin Islands

British Virgin Islands are Caribbean islands (Map 4) located between the Caribbean Sea and the North Atlantic Ocean, east of Puerto Rico. First settled by the Dutch in 1648, the islands became an English colony in 1666 and were part of the Leeward Islands from 1833 until 1959. They are still a British crown colony.

British pounds sterling was used on the islands from 1833 until 1935 when the British West Indies Dollar was introduced. British pounds sterling, British West Indies dollars and US dollars were legal tender, but United States dollars were, and still are, the primary medium of exchange. Since 1973, the British Virgin Islands have produced coins for local use at par with the United States dollar.

The Cayman Islands

The Cayman Islands are an island group located in the Caribbean Sea (Map 4), nearly half way between Cuba and Honduras. The Cayman Islands were part of Jamaica from 1670, which itself was colonised by the British. Formally administered by Jamaica since 1863, it became a separate dependency of the United Kingdom in 1959. It has been a British crown colony since 1962, and has had some degree of self-government since 1972.

Canadian and US fractional coinage were legal tender in Jamaica until 1863 and silver dollars to 1876. British pounds sterling was also legal tender. During the 1870s, Jamaica began minting its own local coins and local banks issued banknotes. The Jamaican government began issuing pound banknotes from 1920 until 1961. British West Indies dollars were legal tender in Jamaica beginning in 1951, though they had limited circulation. The Bank of Jamaica began issuing banknotes in 1961. The Jamaican dollar continued to circulate in the Cayman Islands after it became a separate UK dependency and after Jamaica gained its independence. In 1969, Jamaica replaced the Jamaica pound with the Jamaica dollar. The Cayman Islands dollar replaced the Jamaican dollar at par in 1972. The Cayman Islands introduced a currency board, linking the Cayman Island dollar to the US dollar.

Montserrat

Montserrat is a Caribbean Island located in the Caribbean Sea (Map 4), southeast of Puerto Rico. Montserrat was part of Antigua from 1632 onwards, and thus part of the Leeward Islands. The Treaty of Versailles formally recognized English sovereignty over Montserrat in 1783. In 1871, a federal constitution was established for the Leeward Islands, which included Montserrat. The Federation of the Leeward Islands was dissolved in 1956. The Federation of the West Indies was established in 1958 and included in particular Trinidad & Tobago, Jamaica, and Montserrat. The independence of Trinidad & Tobago and of Jamaica led to the break up the Federation in 1962. Montserrat became an associated state of the United Kingdom in 1967.

United States dollars and British pound sterling circulated in Montserrat until the creation of the British West Indies dollar in 1935. Some local banks in Antigua issued banknotes, but in 1951, the Board of Commissioners of Currency (British Caribbean Territories) became the sole note-issuing authority for the British West Indies dollar. The East Caribbean dollar issued by the East Caribbean Currency Authority (Box 2) replaced the British West Indies dollar in 1965. Montserrat notes have the letter "M" placed on them.

Pitcairn Island

Pitcairn Island is located in Oceania (Map 7), more specifically in the South Pacific Ocean, about midway between Peru and New Zealand. Pitcairn Island was discovered in 1767 by the British and settled in 1790 by Bounty mutineers and their Tahitian companions. Pitcairn was the first Pacific island to become a British colony in 1838 and today remains the last vestige of that empire in the South Pacific.

The New Zealand dollar is used on Pitcairn Island, the Cook Islands, and Ross dependency. Pitcairn Island has issued some coins for numismatic purposes, but none for general circulation.

Turks and Caicos Islands

The Turks and Caicos Islands are located in the Caribbean area (Map 4). They represent two island groups in the North Atlantic Ocean, southeast of the Bahamas, north of Haiti. The Turks and Caicos Islands were part of Bermuda from 1799 until 1848 when they were made a separate colony. They became part of Jamaica in 1874. They were part of the Federation of the West Indies from 1958 until 1962 when the Turks and Caicos once again became a separate Crown Colony.

During the 1800s, English, US and Canadian coins circulated in the Turks and Caicos. Fractional coinage of the US and Canada ceased to be legal tender in 1863, silver dollars of the US ceased to be legal tender in 1876, and British banknotes ceased to be legal tender in 1919. Silver farthings were minted for Jamaica in 1846, and other subsidiary coinage was minted for Jamaica from 1869. Local banks began issuing their own banknotes soon after, and Jamaica began issuing its own local pound banknotes in 1920, creating the Jamaica pound at par with the British pound. British West Indies dollars were made legal tender in 1951, but they had limited circulation relative to the Jamaican pound. After Jamaica gained its independence, the Turks and Caicos Islands continued to use the Jamaican pound. When Jamaica created the Jamaican dollar in 1969, the Turks and Caicos

created the Turks and Caicos crown at par with the Jamaican dollar and equal to 0.5 Jamaican pounds. Whereas the Cayman Islands eventually created their own currency, the Turks and Caicos Islands have chosen to use United States dollars as the medium of exchange.

ANNEX 5

Third countries using the currency of a non-participating Member State – The Channel Islands and the Isle of Man

The Channel Islands, which represent the Bailiwick of Guernsey and the Bailiwick of Jersey, as well as the Isle of Man are neither part of the United Kingdom nor of the European Union. They have a specific status of British Crown Dependencies. They are sovereign with regard to their monetary regime. They have no monetary authorities, but their respective Treasury Departments act in this capacity and are independent from the Bank of England. However, the overall monetary policy in these territories, in general, follows that of the UK. The islands generally (cfr Alderney) issue their own sterling-denominated notes and coins. On the basis of an informal agreement with UK banks, local currency is fully backed and exchangeable at par with the UK pound sterling. Those arrangements are governed entirely by local statute, and without any obligation for the Bank of England, which therefore has no obligation to maintain the parity of the local currencies vis-à-vis the GBP.

Guernsey

Guernsey (Map 2) is a group of islands in the English Channel, northwest of France. It does not form part of the UK, but is a legal dependency of the Crown since the Norman invasion in 1066. It owes allegiance to the Duke of Normandy, Queen Elizabeth the 2nd. The island of Guernsey and the other Channel Islands represent the last remnants of the medieval Duchy of Normandy, which held sway in both France and England, and to which the Kings of England (formerly the Dukes of Normandy) held on. Guernsey includes the northern island of Alderney.

Guernsey had the British pound sterling as legal tender since the 1300s, but used predominantly French currency until the early 19th century. Guernsey has the authority to issue its own currency and began production of banknotes denominated in pounds in 1827 and copper coins denominated in doubles (derived from the French "double deniers") in 1830. In 1921, Guernsey adopted a pound equal to the pound sterling as its currency. Therefore, the Guernsey pound is currently sterling and at par with the British pound. Guernsey still issues both notes and coins. Its notes and coins commonly circulate in the Bailiwick alongside the Bank of England Banknotes and UK Treasury coins. Both the local pound and the pound sterling are legal tender in the Bailiwick of Guernsey.

The island of Alderney has its own currency, which by Law must be the same as the currency of the United Kingdom. Alderney only issues coins, not banknotes.⁵¹

Jersey

Jersey is located in Western Europe (Map 2). It is an island in the English Channel, northwest of France. (For Jersey's institutional links, see under Guernsey). The Jersey Treasury manages the Island's finances and provides notes and coinage.

The livre tournois had been used as the legal currency in Jersey for centuries. However, the livre tournois was abolished during the French Revolution. It remained legal currency in Jersey until declining supplies of livres tournois and resulting difficulties in trade and payment obliged the adoption of the pound sterling as legal tender. The pound sterling became the currency of Jersey by virtue of an Order in Council of 1834, but the livre tournois circulated unofficially thereafter alongside the British currency. Jersey is in a currency union with the United Kingdom and has preserved the authority to issue its own currency: Jersey has issued its own pound banknotes since 1840, and it currently issues both banknotes and numerous coins, at par with the British pound sterling. Both the local pound and the pound sterling are legal tender in the Bailiwick of Jersey.

⁵¹ Schedule 2 of Alderney's government provides that the States of Alderney may, by Ordinance, prescribe "*the legal currency and denominations of the legal currency, so however that that currency, and those denominations shall be the same in Alderney as in the United Kingdom; and prescribing those notes and coins the tender of which is a legal tender of the payment of money.*"

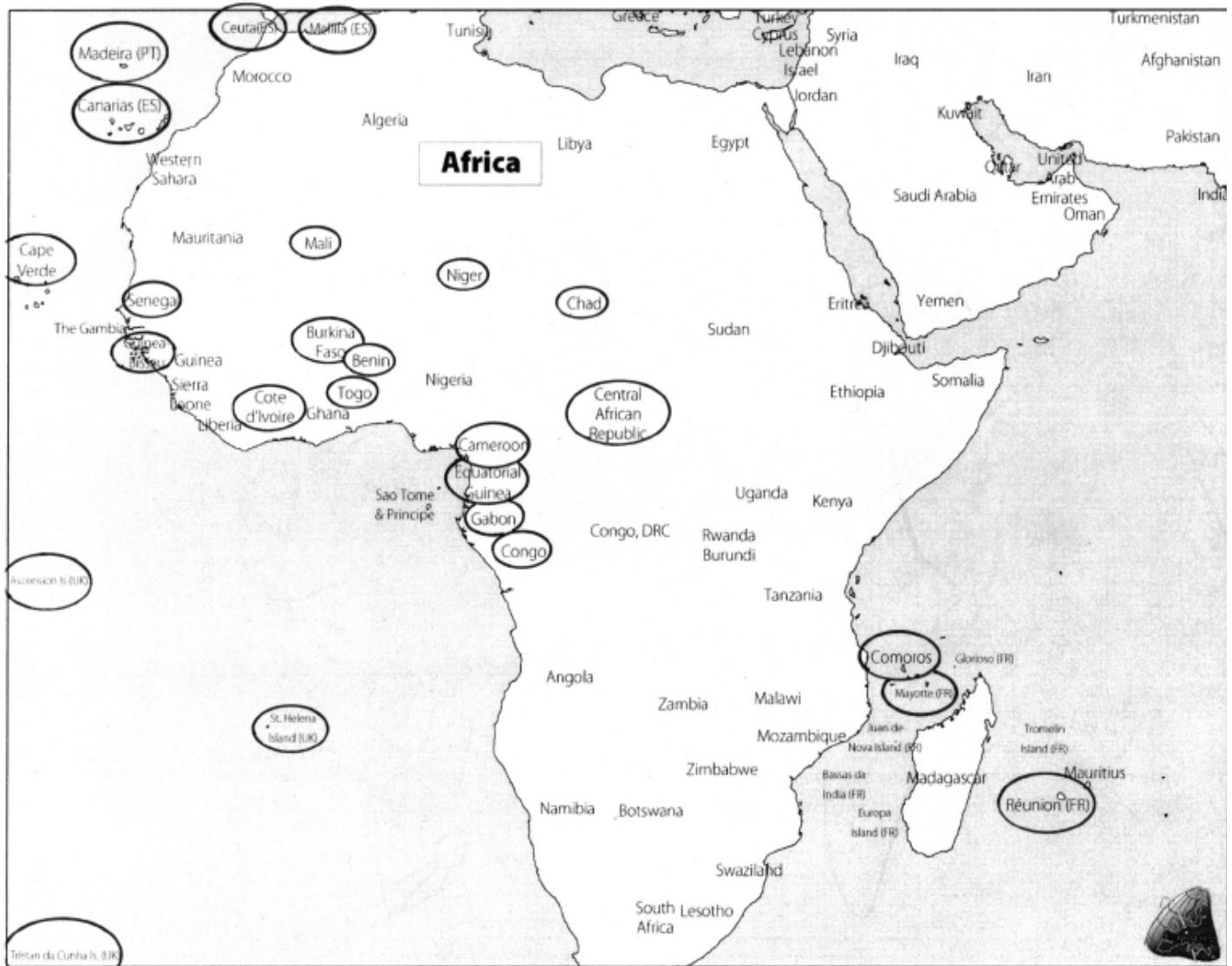
The Isle of Man

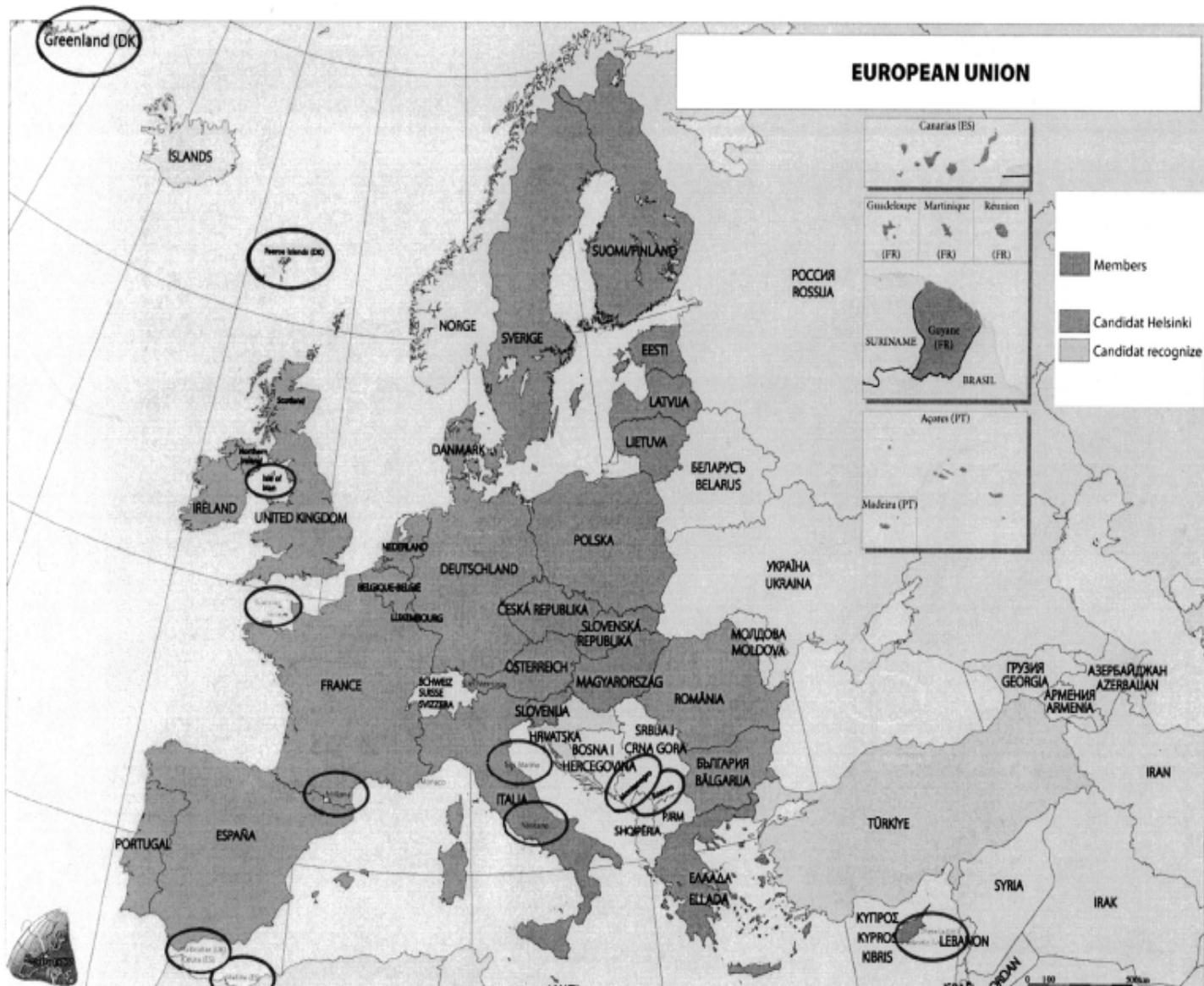
The Isle of Man (Map 2) is an island in the Irish Sea, between Great Britain and Ireland. Part of the Norwegian Kingdom of the Hebrides until the 13th century, the Isle of Man was ceded to Scotland and became a Scottish fiefdom in 1266, and an English fiefdom in 1334. The island came under the British crown and has been under Crown administration since 1765. However, the Isle of Man does not form part of the UK⁵².

The Isle of Man has the pound sterling as currency and has long been in monetary union with the United Kingdom. It does not have the power to set its interest rate or exchange rates. However, the Isle of Man has the authority to issue its own notes and coins. Its notes and coins are commonly used in circulation on the island. The Man pound is interchangeable and at par with the pound sterling, without any form of currency control. Both the local pound and the pound sterling are legal tender in the Isle of Man.

⁵² The Isle of Man is not part of the European Union, but has a special relationship set out in Protocol 3 of the Act of Accession, annexed to the Treaty of Accession 1972, by which the United Kingdom became a member of the EEC. Under the above Protocol, the Isle of Man is part of the customs territory of the Union and it follows that the Common Customs Tariff, levies and other agricultural import measures apply to trade between the Isle of Man and non-member countries and that there is free movement of goods in trade between the Isle of Man and the Union as regards industrial and agricultural products.

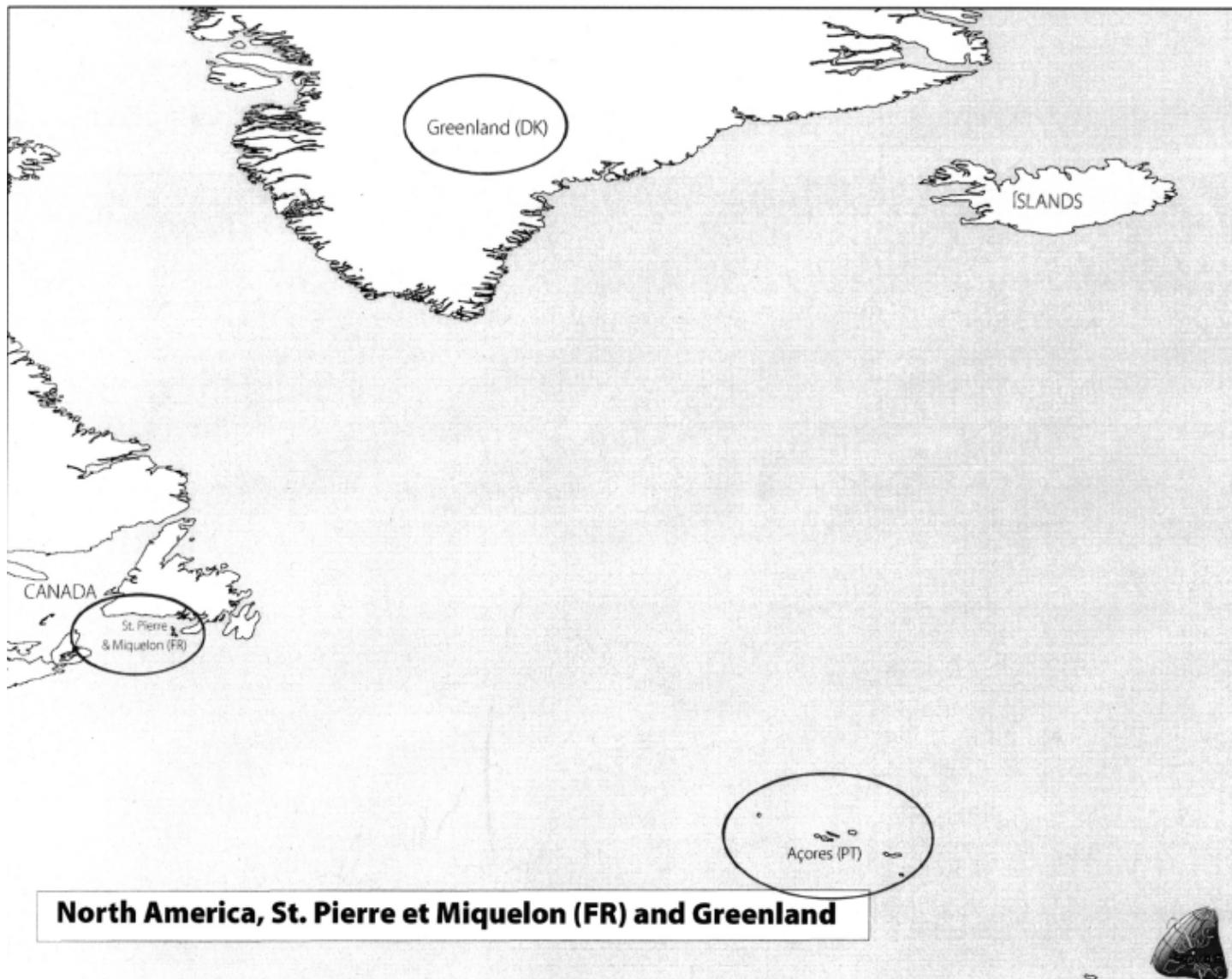
MAP 1 AFRICA

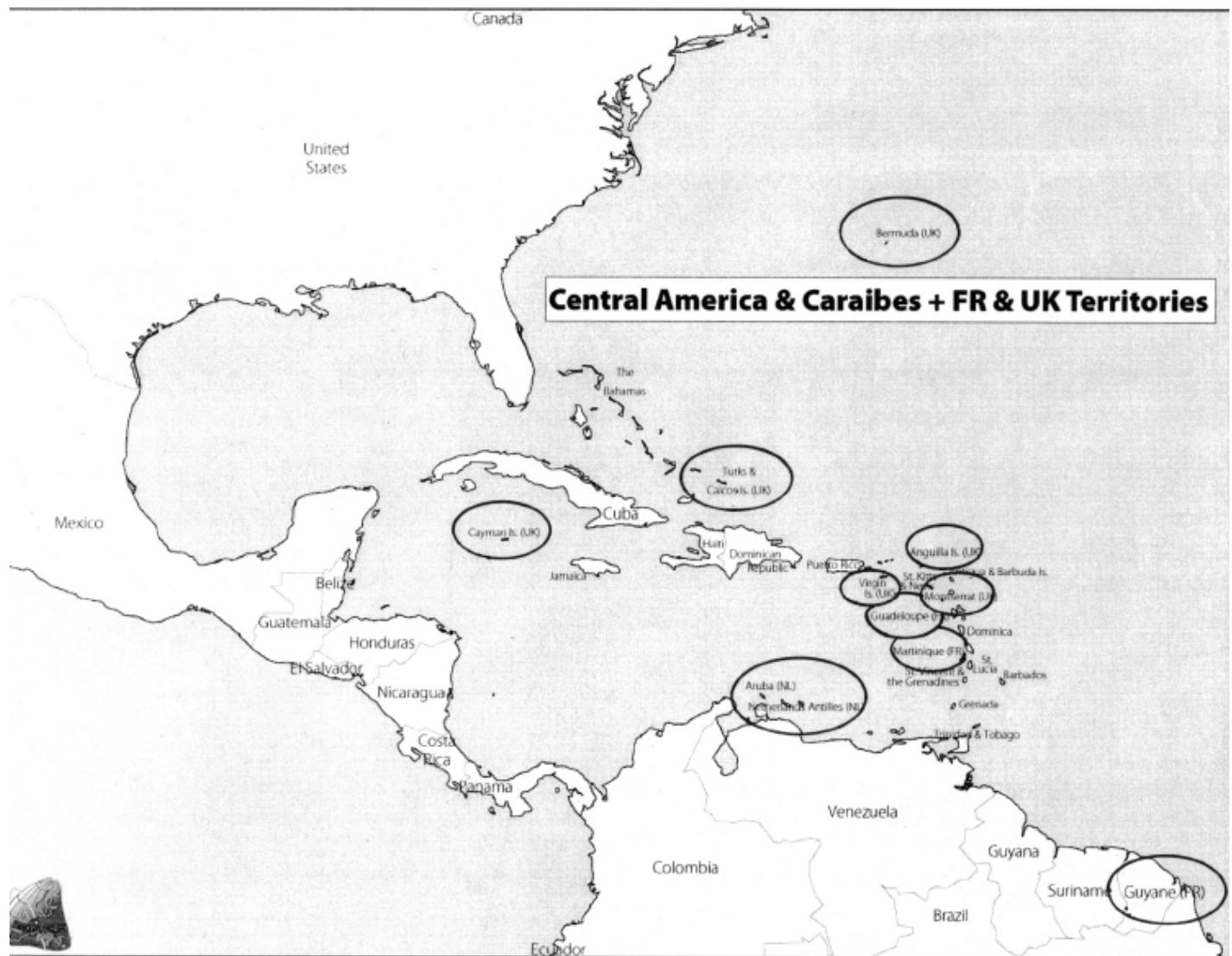


MAP 2**EUROPEAN UNION**

MAP 3

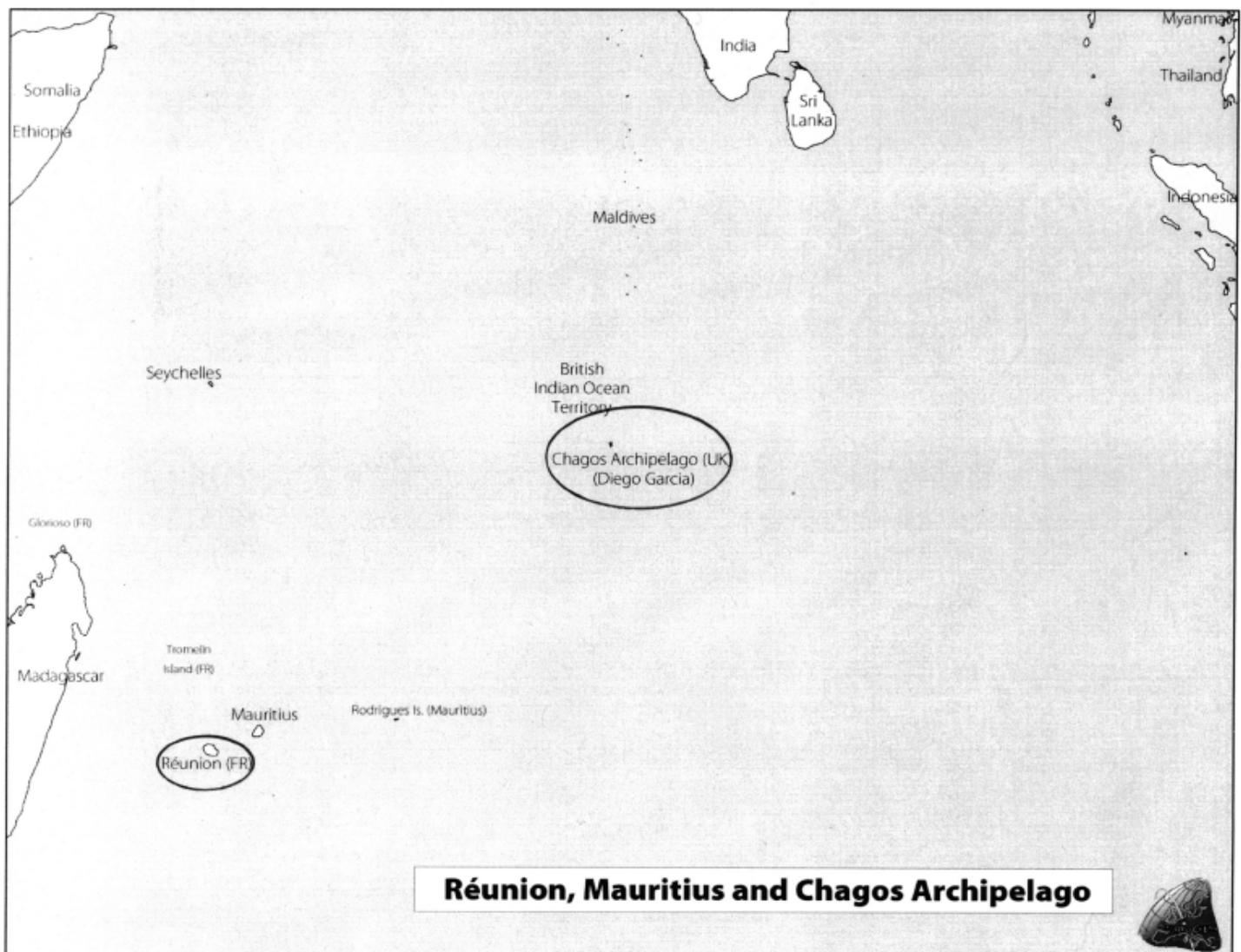
NORTH AMERICA, SAINT PIERRE-ET-MIQUELON AND GREENLAND



MAP 4**CENTRAL AMERICA AND THE CARIBBEAN ISLANDS + FR AND UK TERRITORIES**

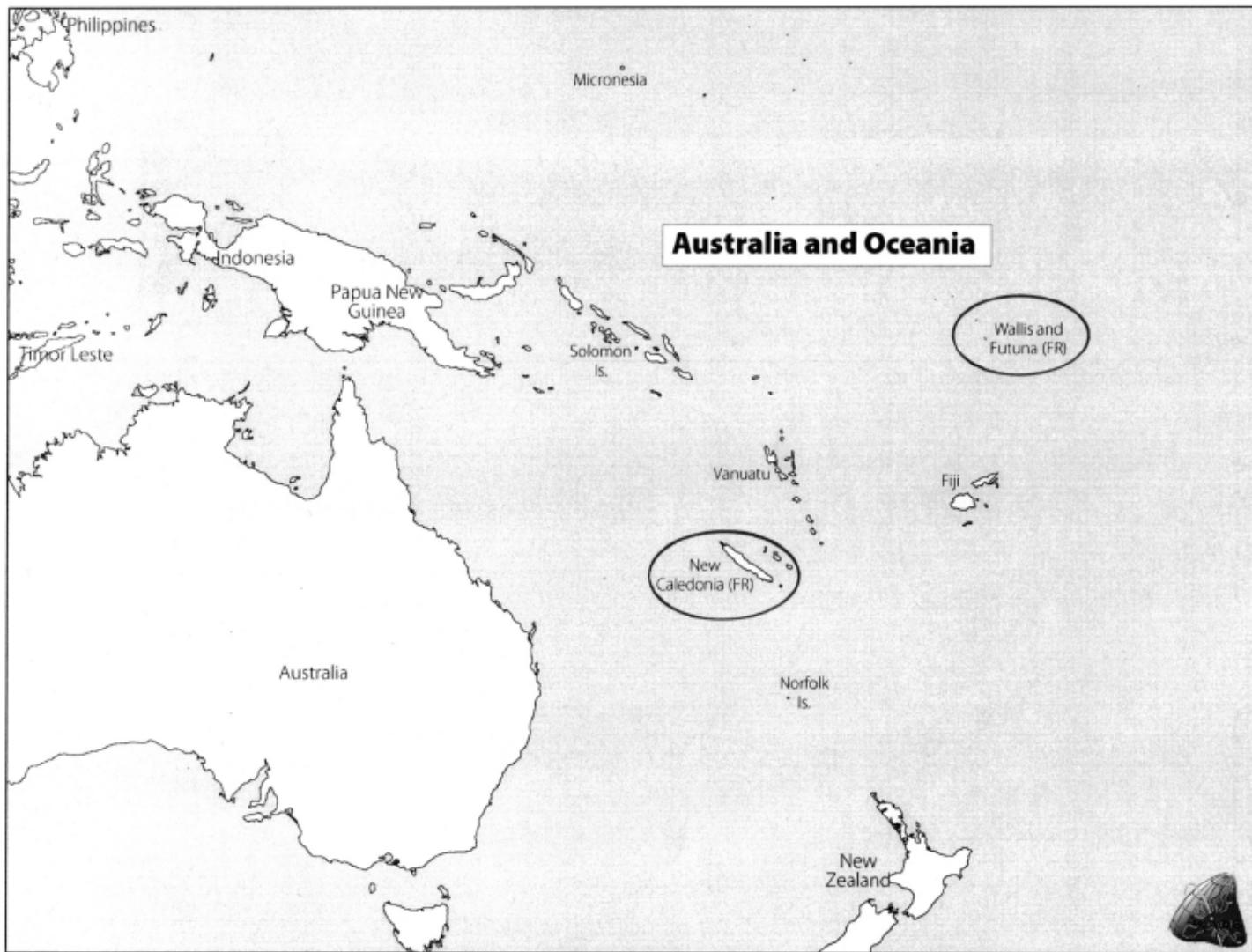
MAP 5

RÉUNION, MAURITIUS AND CHAGOS ARCHIPELAGO



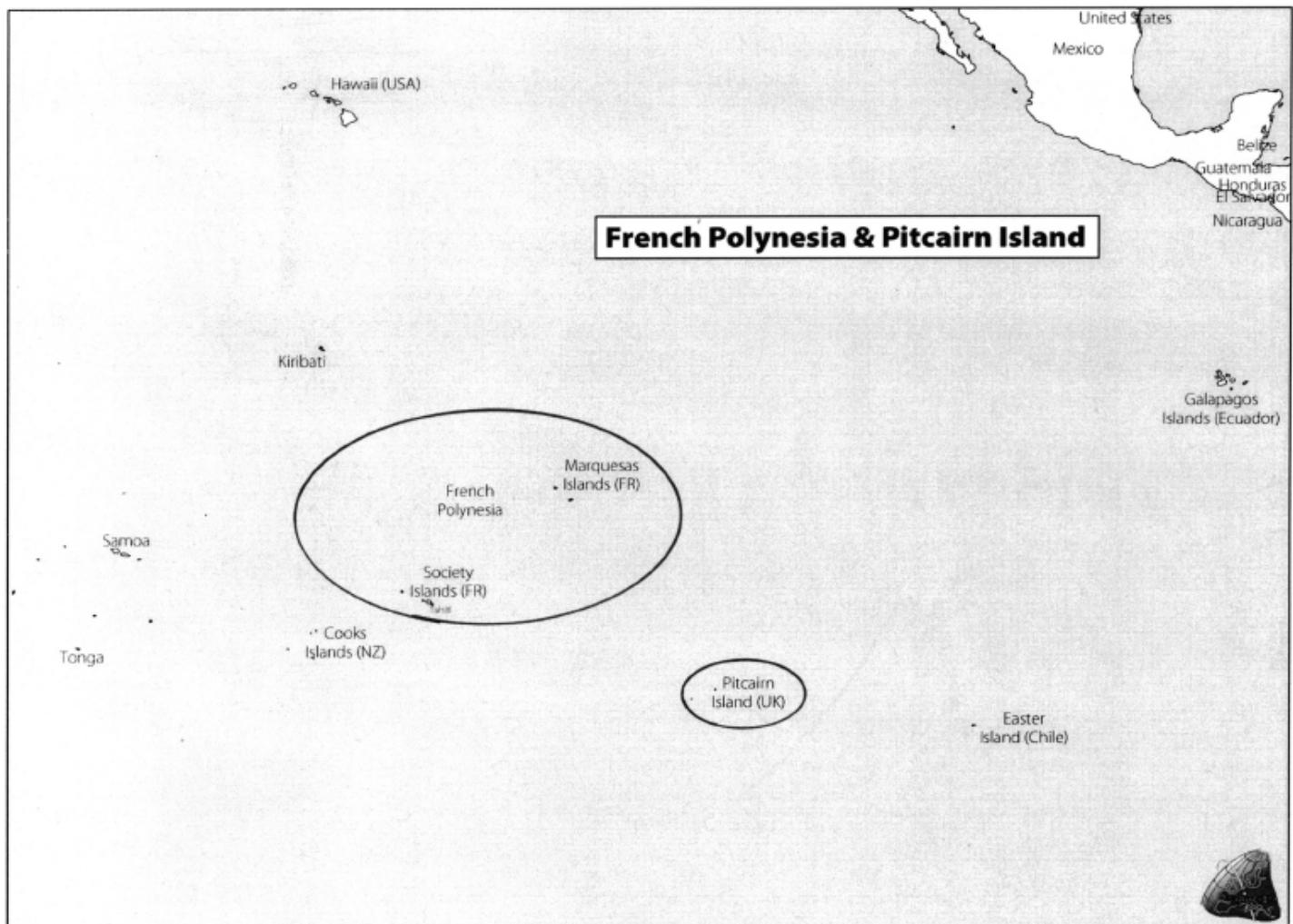
MAP 6

AUSTRALIA AND OCEANIA



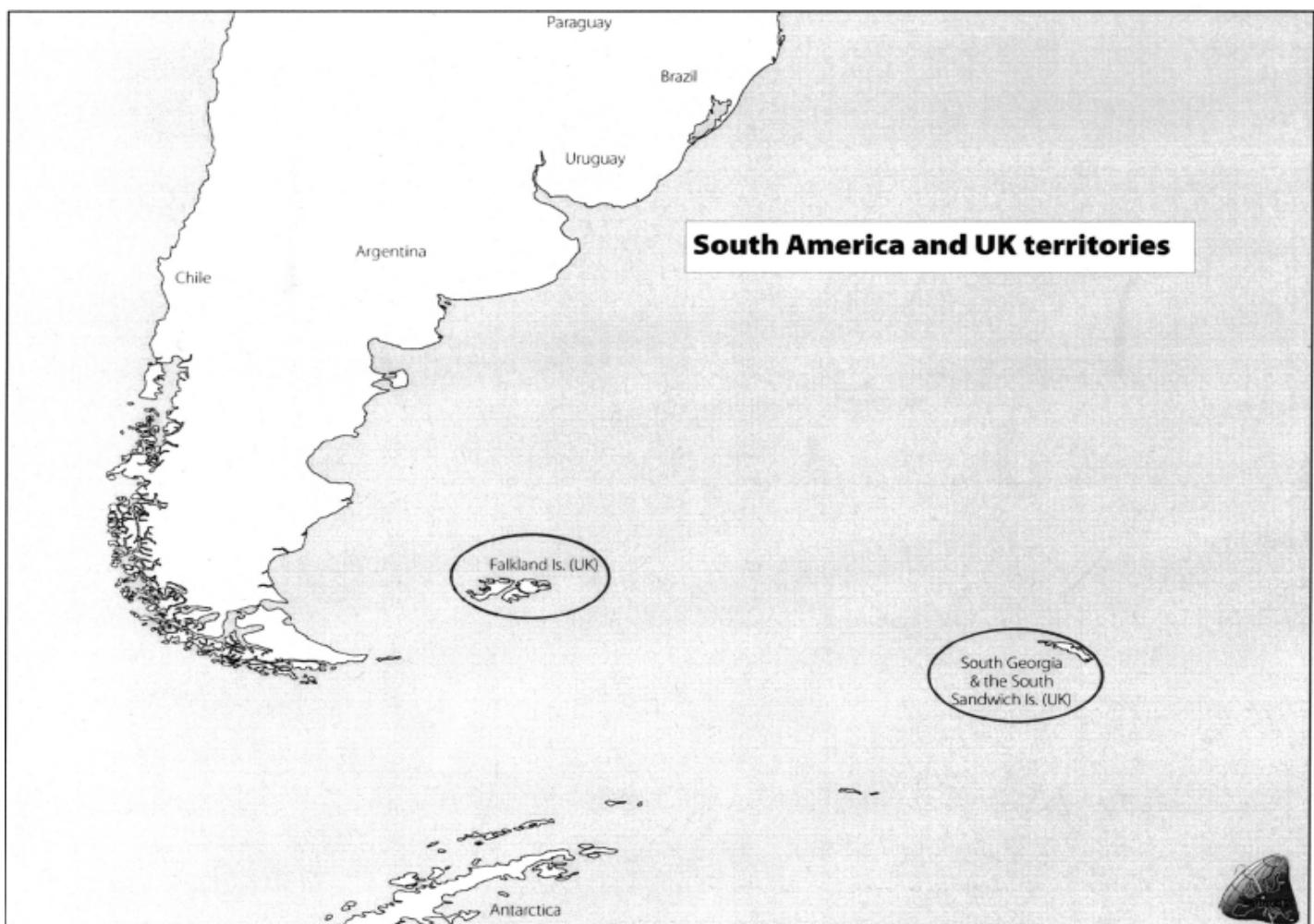
MAP 7

FRENCH POLYNESIA AND PITCAIRN ISLAND



MAP 8

SOUTH AMERICA AND UK TERRITORIES



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