ECONOMIC AND SOCIAL
CONSULTATIVE ASSEMBLY

1994

Transition towards Economic and Monetary Union

EUROPEAN COMMUNITIES

ECONOMIC AND SOCIAL COMMITTEE

Brussels 1994

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The Economic and Social Committee, the Consultative Assembly of representatives of key economic and social groupings in the Member Sstates, is an integral part of the Communities' institutional machinery.

The Committee was set up to involve economic and social interest groups in the establishment of the Common Market and give them an institutional vehicle for conveying their views on live EC issues to the Commission, the Council and the European Parliament.

These views are (mainly) set out in Opinions adopted at Plenary Sessions by a simple majority vote and published in the Official Journal of the European Communities.

* * *

The Economic and Social Committee has expressed its opinion on Economic and Monetary Union several times. The Section for Economic, Financial and Monetary Questions was in charge of preparatory work and appointed Dr. Klaus MEYER-HORN, a German member of the Assembly, as Rapporteur for all of them.

In this brochure, the Committee presents Prof. Alexandre LAMFALUSSY's speech as President of the European Monetary Institute, before the Section for Economic, Financial and Monetary Questions on 6 September 1994 as well as seven Opinions all tackling Economic and Monetary Union, a subject of prime interest to Citizens' Europe and consequently, to the Economic and Social Committee itself.

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FOREWORD

With the beginning of the second stage in January 1994, the transition towards Economic and Monetary Union is well under way. The European Monetary Institute has taken up its duties as the forerunner of the European Central Bank under the leadership of Belgian professor Alexandre LAMFALUSSY.

According to the Economic and Social Committee, the fundamental steps for a careful preparation of the EMU are as follows:

- the economic policies of the Member States must be more rigorously coordinated and subject to multilateral surveillance; in view of current unemployment and recessionary conditions, they must aim at a parallel development; so that a consensus may be reached, the economic and social circles must be briefed and consulted on the convergence and recovery programmes drawn up to that effect;

- the preparation of the Common Monetary Policy requires that the concepts and instruments of monetary policy be harmonized, including the policy of minimum reserves mentioned in the Maastricht Treaty;

- the move from national currencies to a European currency must be prepared - from the printing of bank notes and the minting of coins to the conversion of bank accounts and bookkeeping, portfolio management and trading of securities, mortgage registering and pricing;

- the regulations on the application of a few articles of the Treaty on European Union must be legally implemented, especially those regarding the financing of budget deficits by the Central Banks, alreading prohibited during the transition period, as well as the privileged access of the public sector to financial institutions;

- the legal obstacles to the use of the ECU, under its current form of basket currency, must be overcome; the ECU clearing system must be made to operate smoothly and the use of the ECU spread more widely;

- comparable and accurate statistics, in particular on monetary aggregates, gross national products and public budgets should be made available in good time in order to prepare, survey and judge policy measures and their effects on the monetary and economic policy which the Maastricht Treaty provides for.

Lastly, the Committee is, as ever, in favour of the convergence criteria and the timetable agreed in Maastricht for Economic and Monetary Union. Success will depend on visible progress in cutting unemployment, promoting economic growth and achieving nominal, and ultimately real, convergence between all Member States.

In this brochure, the Social and Economic Committee presents Mr LAMFALUSSY's observations on the mandates of the European Monetary Institute which he chairs and the perspectives of the EMU, as delivered before the Section for Economic, Financial and Monetary Questions on 6 September 1994, as well as seven Opinions, for all of which Dr. MEYER-HORN, a German member of the Committee and representative of credit institutions, was rapporteur.

Over and above its technical Opinions, the Economic and Social Committee considers it important that the public be informed in due time about the consequences of Monetary Union and that a consensus of the economic and social circles it represents among the European institutions be reached.

Brussels, September 1994

Susanne TIEMANN
Chairman of the
Economic and Social Committee

Statement by

Mr Alexandre LAMFALUSSY

President of the European Monetary Institute

held in Brussels,
at Committee headquarters,
before the Section for Economic, Financial
and Monetary Questions,
on 6 September 1994

Statement by Mr LAMFALUSSY

Thank you, President, for your amiable words of welcome. I apologize for being a little late. I would have liked to speak to your Committee even prior to this occasion but, as you know, the Institute's beginnings were not particularly easy: the choice of the seat and the nomination of the President were later than the schedule foreseen in the Treaty of Maastricht, and these decisions, instead of being taken at the end of 1992, were only taken at the end of October 1993, and finalized in December of that year, and we were supposed to start functioning the next day or nearly, without having the initial phase of one year foreseen by the Treaty.

All this means that I am doing two jobs at once: I am making an Institute, which was skeletal to start with, work. It now has flesh on its bones: our institutions, the Committee, the Council, are working as planned since the beginning of January. Simultaneously, we are building, in all senses of the word, the Institute in Frankfurt, with all the recruitment and all the works this entails. I am doing more than one job as I said. This phase will be over in a few months, we will be installed in Frankfurt in a few months' time, at the end of November. I have put at your disposal a sort of profile of the Institute with a brief summary of the main points of our mission and a description of the organization, and I am here to answer the questions you would like to put to me. I do not think, however, that it would be useful to dwell on the organizational aspects which are very important, but which are perhaps not of great interest to yourselves.

The introduction I wished to make will comprise two parts: firstly, I would like to recall before you, in my own words as well as according to the Treaty, the Institute's terms of reference, that I consider paramount and decisive, and secondly, I would like to speak to you of the perspectives of Economic and Monetary Union as I see them today.

First part: the Institute's terms of reference

Things are never simple. I would like to say that there are two points in the terms of reference which I consider to be absolutely fundamental. They are of equal importance, I believe. The one has no priority over the other.

The first point, for which we are particularly competent and have decisional responsibility, is the setting-up of the structure, logistics and organization of the future European Central Bank. One could say that the Treaty gives us the responsibility of creating a Central Bank that is ready to work. In that field, we have decisional power without any outside intervention: it is the Institute's Council which is entrusted with the decision. The Treaty, of course, has defined the basic aims of the Central Bank, and has also spelled out a number of responsibilities and made clear that the conduct of the single monetary policy is the bank's main responsibility. This monetary policy must be pursued with the aim of ensuring price stability. The Central Bank must be independent, it must not receive or solicit instructions from anyone in conducting monetary policy, and it cannot lend the governments money, directly or indirectly. All this is described in the Treaty which sets the framework in which we shall be working, but the details are lacking. Perhaps, there is a good reason for this. For instance, it is said - I quote from memory, please forgive any failings - that, as far as possible, the organization must be kept decentralized: in other words, the national Central Banks must keep the power that is theirs, as much as possible. This is said but, obviously, we must see what is possible and what is desirable.

What is the work that we must accomplish to set up this Central Bank? The heart of the problem is the setting-up of the technique of monetary controls, i.e. determining with what instruments and through which channels the European Central Bank will define and conduct the Monetary Union's single monetary policy. This is a technical field, indeed it is very technical but, behind the cloak of technicity are hidden quite a few very defined interests that we are going to look at as our work makes progress. I should say that, in six months' to a year's time, we are going to be looking at important problems, which will certainly be at the heart of many discussions.

Already spoken of now, as the subject looks less technical, is the question of knowing whether an intermediate objective should be fixed in monetary policy. Of course, the final objective is not in doubt, it is defined by the Treaty: the stability of prices. But, should we or not have an objective as to the amount of money in circulation as practised in certain countries, in particular, in Federal Germany, or should we keep to the final objective, simply, as is now the case in Great Britain, while using a much more varied series of other objectives and indicators?

Finally, we come to a long-debated question, which will perhaps arouse no major difficulties, but perhaps many controversies. But, behind all this, there are much more practical aspects which are very important in the conduct of monetary policy: should compulsory reserves be imposed, and if so, to which institutions, and are these compulsory reserves remunerated or not? Just look at the interest certain banking professions are taking in the decisions about to be taken: all this is a very vast field, that we must define and for which we must be ready in the course of 1996.

A second field, which is also very delicate, is the precise, functional relationship between the Central Bank in Frankfurt with its Council whose structure is well defined by the Treaty, and the various national Central Banks. There is no doubt that the national central banks will continue to function, but we can wonder what kind of relations will be established between them and the centre. There is a wide variety of models throughout the world, the American model, the German one, and others can be invented. There is no doubt that a single monetary policy can be achieved, that is obvious, but to which degree can one decentralize, not the decision-making process as to the stance of the centralized policy, but the implementation? To which degree can implementation be decentralized? There is a problem, but, behind this problem, there are many others.

The question is: to what degree can the various central banks continue to function rather on the national model, looking after a certain number of functions which are not only monetary policy functions? There, we are going to come close to problems very important because practises have evolved in very different directions. In our various countries, some Central Banks have been substantially scaled down, and have got rid of quite a few functions. Reality is very varied in this respect. Is this variety harmful for monetary policy inasmuch as this policy is a single one? I can see no reason to want, absolutely, to harmonize everything. The principle of subsidiarity will naturally exist, and the details, as I have said earlier on, have not yet been gone into.

So, here is a particular field of our responsibility - the organization and setting-up, ready to work, of a Central Bank. We shall be ready. We shall be ready, even if this is not easy as, the more we get down to details, the more, obviously, the details start becoming controversial and important, but I can assure you that I will do all that is in my power so that we are ready, and this is the case of the Council too. Then, the politicians, as this is their role, must say whether, how, with whom and when, we effectively start running the Central Bank. We will have provided the instrument necessary for the political decision to be taken at a certain moment to be effectively carried out.

The second part of our mission is what I will call the management of phase two. I have just been speaking to you of phase three, but we are already living in phase two. In this phase, we have a whole series of very specific functions. I would like to concentrate on a single one, which is central, and that is the present coordination of monetary policies with which the Institute is entrusted today. It will keep this role all along its life, that is to say, up to the establishment of the future Central Bank. You know that, in this second phase which we are now going through, the national monetary authorities fully retain their right to decide as regards monetary policy. In other words, the Institute's Council has no power over the monetary policy carried out by the various Central Banks. This is absolutely clear, and it is for this reason that very often, I am told: but, you are going to coordinate monetary policies without the power of coercion, without being able to impose the coordination, this is an impossible task.

I do not share this opinion, and I do not share it for several reasons. The main one is that the aim of the coordination is quite clearly defined by the Treaty. The Treaty says: coordinate monetary policies today in order to ensure price stability. So, the mission is very clear, the final objective is clearly assigned. I would even say that it is not only a question of the Treaty, because the **de facto** evolution of the various national monetary policies was already set on this track, even before the drafting of the Treaty of Maastricht. Indeed, it is for this reason that, on this particular aspect, there has been, as far as I know, no very lively debate. In fact, for ten or even fifteen years, it has been a known fact that monetary policy must, first and foremost, work on the main task of monetary stability, and ensure internal and external monetary stability. This took place following on a sort of cultural revolution which took place both in economic thought in the 1960's and 1970's and after the stagflation experience of the 1970's. Finally, whatever the origin of this evolution, it is there and has been codified in the Treaty.

If you do not have a debate or any kind of doctrinal divide between the Central Banks, represented at the Institute's Council and which take part in the proceedings, the debates no longer bear on the final objective because, if they did, there would obviously be little coordination. The debate deals with the means of arriving at coordination. How can this be achieved? What is the best way to go about things? In this field, we have very diversified experience and the Central Banks are on an equal footing. There is no single line of thought, at the very least because the objective of price stability is one of the Community's main achievements, and has been, for a number of years.

We have attained, I believe, throughout the Union, a rate of inflation which is an historical minimum and which is very evenly distributed. There are countries, France notably, where the rate of inflation has now been lower than 2% for a few years, and what is more, even in countries which have devalued their currency or let it depreciate, the rhythm of inflation has diminished. This shows the effective convergence of policies. In this climate, however, the tools are varied, and the various Central Banks have recourse to different ones. From this point on, the debate going on is a debate on the means, a technical debate, a very balanced debate. There is no single recipe in this field and I think that, in this situation, coordination can take place without too many difficulties. That is what I can observe at the Institute's Council since the beginning of the year.

There are the two great missions I wanted to speak to you about. We also have a number of very specific missions on which I would like to dwell, if you like. Let me have a quick look at the second theme at the heart of the debate and that everyone is thinking of. Here is the Institute, put in charge of setting up a Central Bank, but what are the chances of this Central Bank effectively seeing the light of day, even if it is well designed as to structure? Will there be a political decision, or will there be none? Of course, I have no answer to the question. But I would like to go back on events and outline some general ideas.

There is no doubt that we were invaded one year ago (it had started one year before this) by a very strong wave of pessimism concerning the possibilities of eventually achieving Monetary Union. We entered the different crises of the European Monetary System two years ago, these went on, and then, it lead to the widening of margins to 15% about a year ago.

At that moment, speaking of the perspectives of Monetary Union would have aroused smiles. I think it was difficult to broach the subject without running the risk of running into sarcasm. I observe that this is not the case now. We are not in a climate of euphoria, and I hope we will not be going back to the climate of euphoria of three years ago, which brought us onto a fairly dangerous path. I think we are now in a situation of greater serenity, which allows us to look at things squarely, with a degree of objectivity, and to have a balanced debate on the chances of suc-

cess of the building of European Monetary Union. Why did this evolution take place?

I will, once again, try to put things simply. It is difficult, in a few minutes, to give all the nuances to the observations I would like to make, but I shall try. The crises we have known between the summer of 1992 and the autumn of 1993 were set off, I believe, by the convergence of three very different influences which, however, lent each other strength. It is their convergence which leads to the gravity of the crisis. These factors are difficult to unravel and, no amount of good will could help me to tell you which of the three I consider the more important. An historical approach is difficult and not always interesting. So, my enumeration will not be by order of importance.

There is an indisputable fact: some of the nominal exchange rates got frozen sometime in 1991 because people started to consider the European Monetary System as a **de facto** Monetary Union. This simply means that divergent trends in the real rates of exchange started to be felt as from 1991, as the inflation rates remained divergent. Convergence took place, but the mere fact of convergence did not make the absolute difference disappear, and as it had remained very considerable, competitive positions started to diverge for a number of countries. For a whole series of reasons, good or bad, it was not possible to make the EMS function as planned, namely as a fixed but adjustable system of exchange rates. Adjustable, if possible, in small steps. It was not possible to do this. I do not pass judgement on those who did not do it, because there is a series of historical explanations which are not important, but they constitute a fact. And, the more decisions were delayed in this field, the more difficult it was to implement them. It was known that a change in one of the exchange rates or one of the pegged rates would probably lead to others, and a chain-effect was feared through the play on anticipations. This blocked the situation completely. This factor, which is a cause, was seen very clearly to appear during the summer of 1992.

The second disturbing factor is the dose of components within macro-economic policy in Germany, following on the unification process. This is a subject which has widely been discussed. You know that, to be able to finance unification in Germany, there has been a sudden and radical change - an extremely important one - in the budgetary balance of Germany. There has been a passage from a situation of relative balance to a situation with a major deficit.

This took place at a moment when the German economy was already rather near to a quasi full use of production factors. It was near the end of a fairly long period of circumstantial upturn, and this change in the German policy mix gave a major boost to expansion, first in Germany, and then, by propagation, in the rest of Europe. The first effect this had was to prolong quite considerably the phase of circumstantial expansion, which was already quite long everywhere.

The first effect of German unification was one of major expansion, perhaps too great an effect, leading to the danger of inflationary sliding. The Bundesbank, in carrying out its duty, could do but one thing, try to use monetary policy to act against the gradual appearance of inflationary tension in Germany. The Germany policy mix was a policy of budgetary expansion counterbalanced by a policy of monetary restriction, which led to high short-term interest rates in Germany. Probably not too high from the German point of view, but certainly too high from that of the other countries of Europe, who were not feeling the same degree of inflationary tension. You there have the normal conflict between a national monetary policy and objectives of international stability. This factor undoubtedly played an extremely disturbing role in the functioning of the European Monetary System.

The third factor is recession. Recession was inevitable, because I do not think anyone has managed to abolish circumstantial cycles. Many would like to do this, but it is an old dream which certainly cannot come true, and there had been a long circumstantial upswing beforehand. The reverse in trend was deeper and the recession more lasting than what could normally be expected. With the accumulation and interaction of these three factors, distortions in the rates of exchange, a very particular policy mix on the part of the largest European economies and, thirdly, a recession, we need not wonder that the working of the European Monetary System was obscured.

If I decided to give you this long account which looks rather historical, it is to tell you that the disturbing character of these factors is now exhausted. We have turned a page. The distortions in exchange rates have been corrected, and perhaps this has even been overdone, but these great imbalances in exchange rates have been cleaned out, the mix of German macro-economic policies has improved, and German budgetary policy seems to me to be on the way back to control. It is not entirely under control, far from it, but, considerable progress has been made and at the same time, without mentioning any figures, let us say that the Bundesbank has relaxed its monetary policy during the past year rather radically, so German short-term interest rates have gone down notably. This factor also has disappeared.

And thirdly - good news - we are getting out of recession at a surprising pace, and what is also surprising is the very firm and very general exit from recession of all the countries of Western Europe.

I do not know what events will be in the two or three coming years, specific disturbances can always crop up. But it looks very unlikely to me that we should again have such a disturbing coincidence of three specific events which, I believe, was a circumscribed accident of history. Perhaps there will be another political event somewhere in the world which could lead to something, but I think that, for the moment, the climate has become much more serene, we have come out of recession. I think that monetary policies are harmonized within Europe and that exchange mechanisms are good.

This, it seems to me, creates a new, serene climate favourable to an examination of the situation and which, with a bit of luck, can last during the coming years. Consequently, political decisions which have to be taken in two, three, four, five years' time will be able to be taken in a more relaxed atmosphere and with less agitation than what we have known during the last two years.

OPINION

of the

Economic and Social Committee

on

The analysis of policies to be pursued in the Community during the transitional stage of EMU

Procedure

On 19 October 1993 the Economic and Social Committee, acting under the third paragraph of Article 20 of its Rules of Procedure, decided to draw up an Additional Opinion on:

The analysis of policies to be pursued in the Community during the transitional stage of EMU.

The Section for Economic, Financial and Monetary Questions, which was responsible for preparing the Committee's work on the subject, adopted its Additional Opinion on 26 October 1993. The Rapporteur was Mr MEYER-HORN.

At its 310th Plenary Session (meeting of 24 November 1993) the Economic and Social Committee unanimously adopted the following Additional Opinion.

1. General comments

The Economic and Social Committee discussed the policies which it deemed to be most suitable for the transitional stage of Economic and Monetary Union. At the end of October it issued a separate Opinion on the economic policies needed to recover from the recession, taking into account the decisions adopted at the European Council meeting in Copenhagen1, whilst the present Opinion will concentrate on policies considered to be appropriate for the transitional stage of Economic and Monetary Union but which are being hampered by the recession. Chapter 1 contains general comments on the policy. Individual policy areas are dealt with in Chapter 2.

1.1. Compatibility of short term economic policy with convergence policy

All Member States of the Community need to pursue more vigorous and parallel economic policies in view of the unacceptably high level of unemployment and the persistence of the economic downturn. If economic policies are not now harnessed to launch an energetic and urgent assault on unemployment[2], the result may be a situation which leaves Economic and Monetary Union looking utopian. If, however, the economic policies needed to tackle the recession, and the convergence programmes which will have to take into account anti-recessionary policies, are coordinated, the economic policies, and in particular the budget policies of the Member States will have a firmer foundation.

1.1.1. Clearly, economic policy faces a dilemma:

- on the one hand, unemployment must be cut and the recession ended as soon as possible;

- on the other hand, the process of integration, which has hitherto been successful, must not be placed in jeopardy. The underlying conditions for reducing unemployment and bringing about an economic recovery could worsen dramatically if, under the effects of the recession, Member States adopted devil-take-the-hindmost policies and flouted the objectives agreed in Maastricht.

1.1.2. With the Internal Market and freedom of capital movements largely in place, economic interdependence and interpenetration is so great that any Member State which goes it alone on economic and monetary policy hurts both itself and its neighbours. Therefore, economic and monetary policy must be closely coordinated within the Community and multilateral surveillance stepped up. The convergence programmes must be adjusted to reflect the recession and be developed into convergence-and-recovery programmes. If economic policy is coordinated at Community level within the framework of multilateral surveillance, preparations for EMU can also continue.

1.2. Common European strategy

Faltering or even negative economic growth, investment cut-backs and, above all, a level of unemployment which climbed from 8.3% in 1990 to 10.5% in mid-1993 require a common European strategy. This must go further than the Edinburgh growth initiative and, in accordance with the decisions taken at the Copenhagen summit of 21-22 June 1993, be expected to cover not only employment but also infrastructure development in the lower income Member States (Greece, Ireland, Portugal, Spain)3. The resources and operating methods of the Structural and Cohesion Funds must be tailored to this objective, particularly with a view to the rapid deployment of resources.

1.2.1. Growth initiatives must, however, in the medium term help enhance the Community's competitiveness vis-à-vis non-Community countries, eliminate the economies' structural weaknesses and permit a return to successful anti-inflationary policies.

1.2.2. The recession must be countered by coordinated economic action in all the Member States. This is a pre-requisite if the Community is to make progress on convergence of economic conditions, even in times of recession.

1.3. Lessons to be learnt from the EMS crisis

At first sight the EMS crisis of late July 1993 seemed to undermine the credibility of EMU. It is now seen as a valuable lesson, however.

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1 ESC Opinion on Growth, Competitiveness and Employment - Medium-term considerations (CES 1010/93).

2 Its actual level is higher than indicated in statistics since figures do not include workers being retrained, in short-term work or on job-creation schemes.

3 The trend in per capita GDP* (as a percentage of the EC average) is as follows (Source: EC Commission, DG II, II 396-93, Table 3, page 28):

	1986	1992
GR	50.6	47.4
IRL	60.1	70.5
P	50.6	57.5
E	70.6	76.7

1.3.1. It highlighted the following:

1.3.1.1. Achieving convergence of the economic fundamentals (inflation rate, employment, progress on productivity, trends in wage costs and interest rates) of twelve countries is always difficult. It becomes still more difficult, however:

- if external pressures occur such as recession, collapse of the Eastern European economic system and its markets, the strain on the German economy arising from the integration of the new "Länder", and the economic consequences of disarmament for the arms industry, and
- if these extraordinary events coincide with a serious recession, which in addition has some structural causes.

1.3.1.2. Under these conditions, the Member States have ceased to converge and have in fact, at times, diverged to some extent. But convergence is a precondition for EMU. Without progress on convergence, a system of stable but adjustable exchange-rates may repeatedly fall prey to speculation,

- if the political will is lacking to adjust parities promptly to reflect divergent trends in economic fundamentals,
- if, instead, exchange-rates which the market regards as misaligned are retained for too long
- and, finally, if political statements cast doubt on the implementation of the Maastricht Treaty.

1.3.2. The following lesson should, therefore, be learnt from the recession:

1.3.2.1. Efforts must be stepped up in the fields of economic policy coordination and multilateral surveillance in order to assure joint, coordinated action to tackle the recession and, simultaneously, tangible progress on convergence. The inadequate coordination of economic policy on the basis of common guidelines was one of the reasons for divergent trends in economic fundamentals from one Member State to another. The result was that currency parities were not always in line with the market, thus undermining the real foundation for a narrow exchange rate fluctuation band. In the properly coordinated economic policy we hope to see in future measures to counter unemployment and the recession are a precondition for, rather than an alternative to the convergence policy required during the transitional stage of EMU. This will, of course, only be possible if currency parities are in line with the market and are not maintained for political reasons at levels which curtail economic growth.

1.3.2.2. The breathing space obtained from the widening of the ERM fluctuation bands may be used to adjust parities in the wake of completion of the Internal Market, in line with individual Member State's progress on convergence. With the new 30% fluctuation band it is to be hoped that parity shifts will be possible without political drama or the immediate speculative testing of the new parity. This would facilitate gradual - and hopefully coordinated - stabilization at new parities.

1.3.2.3. The temporary widening of the fluctuation bands will thus help establish a correct system of parities, which will be irrevocably fixed in the third stage of EMU.

1.4. Widening of the EMS fluctuation bands

Our reaction to the decision taken by the Economics and Finance Ministers and Central Bank Governors on 2 August 1993 to widen the ERM fluctuation bands temporarily from 2.25 or 6% to 15% in either direction is as follows:

1.4.1. Parities already overtaken by manifestly divergent economic trends and no longer supported by the market were, in the past, sometimes retained, not least for reasons of political prestige. Given free movement of capital, the result was abrupt devaluations and currency-market instability. With fluctuation bands widened to a total of 30%, there is now no need to defend parities as soon as an exchange rate slides by one or two percentage points.

1.4.2. The widening of the fluctuation bands gives the Member States a certain amount of scope in economic policy. If the need to preserve monetary stability so dictates, interest rates can be kept relatively high for a time in one country, whilst other countries pursue lower interest rates in order to combat recession and high unemployment. With wider fluctuation bands, such interest-rate differentials are possible, without every change in the interest-rate structure immediately giving rise to speculative "testing" of the sustainability of a given exchange rate. However, in some Member States the defence of the exchange rate seems, at least at times and within certain limits, to take precedence over changes in interest rate policy.

1.4.3. In the past, currencies sometimes entered the ERM at parities which were already regarded by the market as out of date. Under the old, narrow fluctuation bands, a mistake of this kind soon made itself felt. The 30% fluctuation band allows a currency scope to find its right level.

1.4.4. Wider margins will make it easier for those currencies which left the ERM at the end of 1992, because their fluctuation bands were too restrictive, to rejoin. Return ought clearly to be accompanied by suitable economic policy measures. The same applies to applications for ERM membership by the currencies of the EFTA countries wishing to join the Community in 1995.

1.4.5. Retaining the narrow fluctuation bands in August 1993 might have forced other currencies to leave. An EMS effectively comprising only a handful of currencies would have undermined confidence in progress towards EMU.

1.4.6. The temporary wider fluctuation bands discourage speculation, as upper and lower intervention points 30% apart permits much greater fluctuations now before a currency needs to be de- or revalued.

1.4.7. The burden of intervention on the central banks has been lightened; sometimes they were required to commit their entire foreign exchange reserves to support a currency which had within a short time fallen to its floor in the narrow fluctuation band.

1.4.8. Temporary widening of the fluctuation bands should not be construed as support for a system of fully floating exchange rates. It is, rather, a priority decision to counter escalating speculation and to maintain the EMS as such. The maintenance of the EMS is essential if the EC is to continue down the road to EMU; this had been in doubt since the EMS tensions of August 1992.

1.4.9. The temporary widening of the fluctuation band should not be seen as an invitation to relax economic policy efforts. On the contrary: economic policy should be so successful that the wider margin for exchange rate adjustments is used as little as possible.

1.4.10. The central banks should continuously monitor - from 1994 onwards within the framework of the EMI - the extent to which the enlarged fluctuation bands are actually being used and consider the timescale within which gradual coordinated narrowing could be envisaged.

1.5. The convergence criteria and the EMU deadline

The Member States should stick to the convergence criteria agreed in Maastricht and the EMU timetable. This requires political will. In all the Member States, the result of economic policy efforts will depend on visible progress in cutting unemployment, promoting economic growth, and at the same time, achieving nominal, and ultimately real, convergence between all the Member States.

1.5.1. Adjustment of the convergence criteria at this stage would undermine confidence in the feasibility of EMU and inhibit efforts to achieve greater convergence, e.g. in respect of budget discipline and consolidation. On the other hand, keeping to the EMU deadline (as in the case of the 1992 Internal Market project), despite the recession, would be a positive signal. This would make it clear that the prospect of EMU has not been allowed to recede as a result of the recession. 1 January 1999 now seems a more achievable deadline, however, than 1 January 1997.

1.5.2. Well-founded confidence in the ability of a successful, properly coordinated policy to promote employment and economic growth, and at the same time confidence in the feasibility of Economic and Monetary Union, are psychologically important for consumer confidence and the investment climate. Confidence rather than uncertainty may contribute to a revival in the economic cycle and finally to renewed progress on the convergence of economic conditions.

1.6. Public information and consultation of the ESC

Policies for the transitional stage of EMU should include adequate publicity, the appropriate briefing and involvement of the economic and social interest groups, including the social partners, and consultation of the European Parliament, the Economic and Social Committee, and the future Committee of the Regions. There has been an extraordinary lack of official comment on the crisis in the EMS and the prospects for EMU, as agreed at Maastricht. The psychological component of consumer behaviour and the propensity to invest, referred to in point 1.5.2. above, also make publicity important.

1.6.1. It would be helpful during the transitional stage of EMU if suitably presented public information, e.g. a Commission White Paper, were made available on the causes of the EMS crisis and the consequences of EMU, in particular the disappearance of national monetary policy - and consequently of interest rate policy - and the replacement of national currencies by a single European currency, the ECU. To avoid disappointment it would have to be made clear that Economic and Monetary Union will not solve all problems from one day to the next, particularly unemployment and income differentials within the Community. When the time it ripe, the help of national media should be enlisted in order to provide a comprehensive explanation of EMU and boost confidence in the new system.

1.6.2. National parliaments must follow the example of the European Parliament's Monetary Committee in discussing the transitional stage policies. Implementation of the economic convergence programmes requires that the economic and social interest groups affected be informed, and that they support the process. It is therefore not only the European Parliament which should be consulted on the multilateral surveillance of economic and monetary policy and the monitoring of the convergence programmes; the Economic and Social Committee should also be appropriately involved, as the institution representing economic and social interests.

1.6.3. Given the scale and seriousness of the recession, social dialogue should be instituted/stepped up at national level too. This is necessary as each Member State is responsible for implementing its convergence and recovery programme. Social dialogue should deal with the compatibility of the various sectors of economic policy with the convergence and recovery programmes. This applies in particular to tax, wages and social policies. These policies must be compatible with each other and with the concentration of economic policy on combatting unemployment and defending monetary stability. Without such a social dialogue and efforts to achieve consensus, it will be difficult to progress towards nominal (and particularly real) convergence.

1.7. Cooperation on monetary policy and supervision in the EMI

Closer cooperation on monetary policy will require better coordination of monetary policy decisions, in the framework of the European Monetary Institute from 1994 onwards; this will include the joint assessment of the appropriateness of exchange-rate parities.

1.7.1. Even with wider fluctuation bands, the problem of speculation will not go away entirely; closer cooperation is therefore needed between the central banks on currency-market intervention. The larger banks active on the foreign exchange markets should perhaps also be involved in this cooperation. Cooperation between Central Banks will be made easier if, as provided for in the Maastricht Treaty, they become independent as soon as possible.

1.7.2. The faster the currency markets react, and the greater the financial flows resulting from capital movement freedom, the more important closer cooperation between Central Banks becomes. According to statistics of the Bank for International Settlements, such capital movements amount on average to about 880,000 million dollars per day, i.e. more than three times the combined foreign currency reserves of the Community's Central Banks (approximately 300,000 million dollars).

1.7.3. Speculation has been made easier by shortcomings in the harmonization of prudential banking regulations. The EMI should, therefore, attempt to secure rapid closer cooperation between the central banks and other supervisory authorities, particularly as regards the off-balance-sheet transactions referred to in point 1.8.2.1.

1.8. Guidelines for action to counter currency speculation

It would be wrong to attempt to curb currency speculation by reintroducing controls on capital movements. This would be an unacceptable setback for the Internal Market.

1.8.1. The most effective way of tackling speculation is of course to remove the reason for it. The Member States would have to do more to bring their currency's exchange-rate into line with economic reality, and ensuring that their successful economic policies do not give rise to over- or under-valuation which would encourage speculation. There has at times admittedly been speculation against EC currencies, e.g. the French Franc, whose economic fundamentals - apart from unemployment - hardly suggested an incorrect exchange rate.

1.8.2. Instead of controls on capital movements, rules to restrain currency speculation could be envisaged. The measures referred to in points 1.8.2.1. and 1.8.2.2. below could be coordinated with major non-Community countries in the framework of the Group of Ten in Basel.

1.8.2.1. Stricter supervision of the speculative use of swaps, futures, options and other off-balance-sheet banking transactions are required. The value of some banks' off-balance-sheet transactions exceeds their balance sheet totals.

1.8.2.2. Compulsory interest-free deposits with the central bank to cover open currency positions could be considered.

1.8.2.3. The introduction of a two-tier currency market, as used to exist in Belgium without any restriction on capital movements, has had little success in the past owing to the considerable administrative work involved and the loop-holes. This would mean however that most currency transactions not directly connected with trade in goods and services, i.e. including monetary and capital movements, were carried out at an exchange-rate freely set by the currency markets, with a certain premium vis-à-vis the official rate. Without affecting the exchange-rate for external trade, this would make cross-border monetary and capital investments, including speculative ones temporarily more expensive.

1.9. Joint economic policy efforts

Since economic policy must now be directed first and foremost at combatting unemployment and promoting economic recovery, many people have begun to have doubts about whether the timetable for achieving Economic and Monetary Union can actually be observed. Despite this, consistent and coordinated economic policies are perfectly capable of making conditions more conducive to the completion of Economic and Monetary Union by the end of the century.

1.9.1. The prospects of achieving EMU would nonetheless be diminished if confidence in the feasibility of Economic and Monetary Union were undermined by the discussion of less stringent convergence criteria during the general economic crisis. It is more important to retain the existing convergence criteria even if such criteria cannot be met in the manner hoped for during the present economic crisis. This does not, however, mean that the budget policy criteria do not need interpretation. This applies in particular to the criteria concerning the ratios of government debt and net borrowing to GDP.

1.9.2. The recession makes the time allowed for convergence policy in preparation for EMU seem short, even if the earlier deadline of 1 January 1997 is abandoned and the third stage begins on 1 January 1999. Under the convergence protocol, even the major economic variables need to converge strongly enough by 1995-1996 to enable currencies to fluctuate within a 2.25% band without undue strain in the final two years (1997-1998). This would require extraordinary economic policy efforts.

1.9.3. The efforts referred to in point 1.9.2. above would, however, be worthwhile, as the economic interdependence between the Member States, achieved via integration in the Internal Market, must be secured for the long term. The opening-up of Eastern Europe, problems of (partly structural) unemployment, demographic and structural development, migration and environment protection mean that, without the agreed EMU (despite the progress made towards integration) the EC might revert to the classic pursuit of national self-interest. Without the constraints of EMU, inflationary full-employment policies, based on protectionism and exchange controls, might be pursued in some Member States.

2. Comments on individual policies

2.1. Short-term economic policies and convergence policies

2.1.1. The convergence sought for economic and Monetary Union, is not fundamentally called into question by the economic policies dictated by the recession and unemployment. The economic and budget policies required by the recession are necessarily similar in all Member States of the Community. Because of this, the conditions which need to be met to achieve Economic and Monetary Union are changing along similar lines in all Member States.

2.1.1.1. Some of the convergence criteria, notably budget criteria, can in the present recession only be given medium-term priority. However, in some Member States the budgetary policy criteria are clearly still being interpreted very restrictively, which limits the scope for the necessary short-term policy measures. In a recession the budgetary criteria should not be allowed to result in, or even be used as a pretext for, economic measures which are likely to exacerbate the crisis even further.

2.1.1.2. By contrast, the policies needed everywhere in Europe to bring down unemployment and stimulate economic growth may at the same time help lay the common foundations for Economic and Monetary Union, provided such policies are coordinated at Community level within the framework of multilateral surveillance. Further cuts in long-term interest rates will be of crucial importance here. This is the only way for some Member States to make up lost ground on convergence - which was one of the main causes of the currency realignments.

2.1.2. There is a close link between the policies needed for cyclical and structural reasons and those needed for convergence. This can be seen from some of the convergence criteria themselves. These are in no way geared solely to "fine weather periods". Rather, a series of relative convergence criteria are tailored, as a precautionary measure, to those Member States whose economic and monetary policies are the most successful in comparative terms. It is worth noting that the convergence criteria, particularly inflation and interest rates, are currently being met by many EC countries. Convergence is possible even in recession.

2.1.3. Budget convergence criteria are expressed in absolute percentages, i.e. new government deficit to be no more than 3% of gross domestic product, accumulated government debt to be no more than 60% of gross domestic product. Articles 104c(2) and 104c(3) of the Treaty, however, explicitly provide for a discretionary margin in assessing whether the ratio of government debt to GDP "is sufficiently diminishing and approaching the reference value at a satisfactory pace" and, subsequently, "whether the government deficit exceeds government investment expenditure", etc.

2.1.4. The Committee endorses the suggestion made by Commission President, Mr DELORS, that additional criteria relating to youth and long-term unemployment be considered as indicators of real convergence.

2.2. Economic policy

2.2.1. The sixth recital of the Treaty on European Union asserts the Member States' resolve to work towards economic convergence and an Economic and Monetary Union, including a single and stable currency.

2.2.1.1. An economic policy aimed at sustained convergence (Article 103(3)) is to be closely coordinated and subject to multilateral surveillance. To this end the convergence programmes, to be adjusted to recessionary conditions, some of which run until 1996, and the ban on budget deficit financing by the Central Banks (Article 104(1)) must be put into effect.

2.2.1.2. The downturn has revealed a number of weaknesses of the EC economy:

- its inability to generate and maintain sufficient new jobs;
- its relative lack of progress on innovation, technology and research; and
- the Community's current loss of global competitiveness, admittedly determined in part by external trade relations[4].

2.2.1.3. The Commission should submit its forthcoming White Paper on a medium-term strategy for growth, competitiveness and employment by the end of 1993 at the latest. Anti-recessionary policy should as far as possible take account of the requirements of convergence policy.

2.2.2. The fact that ten Member States have already submitted convergence programmes is to be welcomed. The two remaining Member States are also expected to do so.

2.2.2.1. The convergence programmes must be expanded to become convergence-and-recovery programmes. Cutting unemployment must take priority over strict compliance with all convergence criterion.

2.2.2.2. With the drawing-up of convergence programmes still the responsibility of individual Member States, the joint discussion and evaluation of such programmes in the Council of Economic and Finance Ministers helps to ensure that Member States are dissuaded from taking isolated national economic policy decisions which would in any case be open to question given the ever-closer enmeshment of national economies. Moreover, coordinated convergence programmes encourage the growth of a genuinely common money market, as well as the general formation of savings

[4] cf. ESC Opinion on the Annual Economic Report for 1993 (CES 1011/93, point 2.2.8.).

beneficial to such a market. The convergence and recovery programmes should, therefore:

- be based on common assumptions and forecasts:

- be for the same period; and

- be discussed and assessed together at EC level.

2.2.3. In the current recession the monitoring of national budgets to identify "excessive" government deficits takes on a different meaning (Article 104c(2)).

2.2.3.1. It is now more a question of limiting the unavoidable new borrowing required to finance extraordinary expenditure, not only because of the convergence criteria (cf. point 2.3.5.), but also because of the already considerable burden imposed by debt servicing on the budgets of some Member States. If the cost of servicing government debt absorbs a high proportion of the budget, the debt must be gradually reduced, quite independently of the constraints of EMU.

2.2.3.2. The extraordinary expenditure referred to in point 2.2.3.1. should be concentrated on public-sector investment, which:

- creates new jobs;

- promotes training and retraining; and

- makes specific improvements to infrastructure, thus attracting additional productive investment from the private sector.

2.2.4. The economic constraints affecting Germany are a special case for Community convergence policy.

2.2.4.1. German economic policy, and above all management of the money supply, are being hindered by an event unique in this century: the integration into the Federal Republic of the former GDR, a State with a population of 17 million, ruined by 40 years of central economic planning. The resultant considerable strain on Germany's economy and budget can be gauged to some extent from the scale of the financial transfers to the east and the new borrowings of the Federal Government.

2.2.4.2. The Bundesbank has reacted to relatively high inflation by German standards with higher interest rates than the depressed state of the economy would otherwise warrant. The Bundesbank's stability-orientated policy bolsters confidence in the D-Mark. But the resultant interest rate differentials complicate the economic and monetary policies of Germany's neighbours and impede the achievement of consensus at EC level, particularly as the D-Mark is still seen as the EMS' anchor currency.

2.2.5. In the transitional stage of EMU a partnership should be developed between Central Banks and Governments not only in respect of economic and monetary policy, but also in respect of subsequent cooperation between the European Central Bank and the Council of Economic and Finance Ministers. Cooperation will be needed as its common monetary policy will be run by the European Central Bank, whilst economic policy is to remain in the hands of national governments even though there will be coordination in the Council of Economic and Finance Ministers.

2.2.6. The tensions it is already possible to foresee between the common monetary policy and national economic policies lead to the conclusion that further progress towards political union will need to be made in conjunction with economic and monetary union.

2.2.7. A policy which seeks to achieve greater convergence also calls for progress in the harmonization of direct taxation of companies and households, particularly withholding taxes on investment income. The EC Commission should publish a White Paper containing proposals at an early opportunity.

2.2.7.1. Harmonization of direct taxes must extend to the entire financial area of the Community, including the "tax havens" which still exist on the territories of individual Member States. As far as is possible, harmonization must also embrace third countries, in effect the OECD countries, in order to counter the exodus of capital for tax reasons. Lower direct taxation would only be acceptable when agreed at EC level under the common regional policy for the purpose of bolstering economic and social cohesion.

2.2.7.2. Differences in the taxation of investment income and the distinction made in this connection between foreigners resident in a country and nationals resident abroad, and between residents and non-residents of a particular area, have no place in a Single Market in the run-up to EMU. With free movement of capital, this differential taxation leads to the diversion of financial flows, usually within the Community, but in some cases also to the benefit of non-Community countries. There is no justification for this in a European financial area. It depresses tax revenues, an undesirable development at a time of budget consolidation and the control of burgeoning budget deficits.

2.2.8. Structural, Investment and Cohesion Fund resources must be used efficiently to secure the desired multiplier effect, with the involvement of national bodies and the financial participation of regional lending institutions, to be encouraged by the provision of public guarantees.

2.2.9. The specific promotion of SMEs, particularly through investment incentives, is of particular importance. SMEs have a major part to play in economic recovery and especially job creation.

2.2.9.1. The promotion of SMEs through increased global loans by the European Investment Bank and the provision of Structural and Cohesion Fund finance (e.g. the Interim Cohesion Fund) is particularly important to those Member States with income levels at less than 90% of the Community average. These countries already have much ground to make up, relatively speaking, to meet the nominal convergence criteria, and their efforts to bring their economic fundamentals closer to the average and to make

progress on real convergence must be supported, i.e. by recourse to the Structural and Cohesion Funds.

2.2.9.2. We need of course to remember that the provision of finance from Community Funds was intended first and foremost to make it easier for countries to advance further towards the convergence necessary to prepare the way for Economic and Monetary Union. The financing available from such Funds, however, is such that all it can do is complement the measures now needed to fight the recession; it certainly cannot replace such measures.

2.2.10. Economic and financial policy must be framed in such a way that the priority attached to economic growth in order to cut unemployment does not lead in the medium term to neglect of the convergence criteria. Given the recession, we cannot expect government debt and budget deficits to be reduced and come rapidly into line with the convergence criteria reference values (Fifth Protocol, Articles 1 and 4)[5]. This is already impossible because most Member States did not use the opportunity of the sustained economic boom in the 1980s for budget consolidation and discipline, so that there is now little scope per se for deficit spending. We must also take into account the fact that, because of the scale of unemployment and the depths of the recession, Member States have been less successful than expected in meeting the government debt and budget deficit criteria, whilst some Member States have even started to move further away from such targets. However, a circumspect approach is adopted by the Maastricht Treaty (Article 104c(2)) which stipulates that attainment of the convergence criteria is to be assessed in the final analysis not on the basis of an exact percentage, but rather in terms of substantial and continuous progress towards the reference value. This assessment should take account of the economic policies dictated by the scale of the recession.

2.2.11. The convergence programmes so far drawn up by nine Member States must be brought into line with the Commission's revised growth forecasts and expanded to become convergence-and-recovery programmes. This applies to countries which have submitted particularly ambitious convergence programmes, e.g. Greece which has proposed a programme aimed at reducing government debt from 106% of GDP in 1992 to 92% in 1996. It would also be helpful if the two countries which have not yet submitted convergence programmes (invoking economic fundamentals so far broadly in line with the convergence criteria, or an EMU opt-out clause) were to do so.

2.3. The convergence criteria

2.3.1. The convergence criteria were drawn up in better times. This does not however mean that they should now simply be adapted to reflect recessionary conditions. It would be a serious mistake to water down the convergence criteria and/or postpone the 1999 EMU deadline because of currently unfavourable economic trends. This would undermine confidence in a determined policy stance on EMU, and in the feasibility of EMU. It is by no means certain that the historical opportunity for monetary union will come again in "better times" with less stringent convergence criteria.

2.3.2. On the other hand, it would also be a mistake to apply all the convergence yardsticks simultaneously in the current recession. The scale of unemployment and the recession, along with the economic and budget policies needed to tackle them, mean that, with perhaps one exception, no Member State of the Community is currently able to fulfil the budget criteria. We should not however leap to the conclusion that the convergence criteria cannot be fulfilled at a later stage of the transitional phase and that monetary union by 1999 will be totally out of the question. Many would seize on such a conclusion as a welcome pretext for rejecting monetary union outright here and now.

2.3.3. It would be equally dangerous to use a snapshot of the convergence criteria as a basis for speculating as to which Member States will be among the founder members of a monetary union in five years time, and which will not. This black and white approach is inappropriate and unjustified. Statistics covering a number of years (on inflation rates, government debt, budget deficits, interest rates and exchange-rates) give a clearer impression of the prospects for progress on convergence in the near future. In assessing the statistics and calculating the convergence criteria percentages, it should be ensured that the data are comparable and that financial policy data include any separate government budgets and assets.

2.3.4. The convergence criteria are important mainly because they have been, and are, interpreted as a quality standard for the future monetary union, a guarantee of monetary stability, which the Maastricht Treaty makes the main plant of the European Central Bank's monetary policy. Most Member States endorsed the Maastricht Treaty because of this confidence in the stability of a European currency. This makes the inflation rate criterion particularly important, even though it is only a relative standard, based on the performance of those Member States with the lowest inflation rates at any given moment.

2.3.5. Discussions about reducing budget deficits and consolidating government debt should not however be reduced to a simple reference to the two relevant convergence criteria in the field of budget policy (Fifth Protocol and Article 104(c) of the Maastricht Treaty).

2.3.5.1. The most important question on budgetary policy is that of the structural problems which resulted from carefree public spending during the boom years[6]. The level of expenditure incurred during those years cannot now be sustained in the context of a competitive world economy. This is true not only of social spending but it also applies to other areas such as industrial and agricultural policy, and to the expansion of spending on public-sector administration.

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5 According to the Commission's 1993 Annual Economic Report, average budget deficits in 1992 rose from 4.6% to 5.3% of GDP, and government debt from 60.4% to 62.8%.

2.3.5.2. The structural problems of central budgets even throw up the question of how far, under the given circumstances, public expenditure can actually bring down unemployment, which is also to some extent generated by structural factors.

2.3.5.3. The cost of servicing government debt has risen by several percentage points on average throughout the Community in the last few years. Irrespective of convergence criteria in the monetary policy sector, this is in itself a dangerous development for which a solution has to be found.

2.4. Monetary policy

2.4.1. The Section concurs with the view expressed in the second Annual Report of the Committee of Governors of the EC Central Banks that EMS parity changes must remain possible during the transitional stage of EMU in the event of serious economic imbalances.

2.4.1.1. But parity changes alone are not enough; they must be backed up by stabilization measures. Only if this happens can there by any guarantee that the European Monetary System will once again come to be regarded as an area of relative stability.

2.4.1.2. The discipline imposed by the exchange-rate mechanism of the EMS has in some EC countries led to adjustments in inflation rates, productivity, as well as production and labour costs, not however in interest rates. The EMS will be called into question if the wider fluctuation band means that a deterioration of the relevant economic fundamentals simply results in the exchange rate being allowed to float downwards. On the other hand, is it right for a central bank to oppose a slide in the exchange rate, thereby imposing excessively high interest rates?

2.4.2. The Committee welcomes the decision taken by the Finance Ministers and Central Bank Governors at Kolding on 21 May 1993 on closer joint monitoring of economic and monetary policy to make it possible to examine the need for realignments in good time. This still applies with wider fluctuation bands. The European Monetary Institute (EMI), which is due to start work in January 1994, has an important role to play in this respect.

2.4.3. It is therefore regrettable that a decision on the location of the EMI and on its President was delayed until the European Council meeting of October 1993. The delay in taking this important decision has itself contributed to uncertainties on the foreign exchange markets.

2.4.4. An open, reciprocal flow of information on exchange-rate policy as recommended by the Committee of Governors of the Central Banks of the Member States, is needed. Even given wider fluctuation bands, exchange rate policy remains a matter of common interest, as the EEC Treaty Article 107 states. A prior reciprocal flow of information on exchange-rate policy would help to prevent competitive devaluation. EMS cooperation, and convergence towards the conditions for monetary union in the transitional stage, would be seriously hampered if there were to be even a hint of the kind of "beggar my neighbour" policies seen in the 1920s, when individual countries sought a competitive advantage for their exports by devaluing their currencies.

2.4.5. The scope for still closer monetary cooperation from January 1994 onwards under the aegis of the European Monetary Institute should be fully exploited. This will require the preparation of a common monetary policy and uniform policy machinery for monetary union. The participation of all the Central Banks in this closer cooperation and in paving the way for monetary union would be the best way of ensuring that as many Member States as possible join monetary union from the outset and that others will soon flow.

2.4.6. It would be a mistake for a handful of countries to form a sort of mini-monetary union on the basis of separate intergovernmental agreements outside the scope of the Maastricht Treaty. Seriously planning for such a step would split the EC and possibly even necessitate the renegotiation of a - different - EMU: instead it is important to adhere to the principle that EMU, as agreed on in the Maastricht Treaty, should be open to all Member States on an equal footing, including those EFTA countries joining the Community over the next few years.

2.4.7. Under Articles 109g and h of the Maastricht Treaty, the Economics and Finance Ministers and the European Council will decide which Member States will participate in EMU from the start. This decision should not discourage the joint efforts to achieve an EMU embracing all the Member States. An EMU with initially limited membership should encourage the other Member States to converge and to join EMU themselves before long. In its time, the EEC itself demonstrated the feasibility of an economic community, which six other countries subsequently joined. Similarly, the Internal Market and the prospect of EMU have encouraged the remaining EFTA countries to apply for EC membership.

2.4.8. Over the next few years it will be crucial for the Member States to combine their efforts to reduce unemployment and end the recession, without however renouncing economic convergence in preparation for EMU.

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[6] cf. ESC Opinion on the Annual Economic Report for 1993 (CES 1011/93, points 2.2.1. and 3.1.2.).

APPENDIX

MAIN ECONOMIC DATA

for the European Community covering the period 1992-1993

(estimate* drawn up by Commission DG II as of July 1993)

	1992	1993	1994	1995	1996
GDP rate of % change at constant prices	2.5	-0.4	1.3	2.2	3.2
Inflation rate	4.8	4.2	3.8	3.3	2.8
Unemployment rate	9.8	11.5	11.9	12.0	11.5
Public sector net new borrowing*	4.4	6.3	5.8	5.1	3.5
Government debt*	60.0	68.8	72.1	74.3	74.5
Real long-term interest rates	4.3	5.0	4.3	4.0	3.5
Unemployed in millions	14.5	16.7	17.3	17.5	16.9
Employed in millions	130.9	128.9	128.7	129.3	130.6
Government*	5.4	5.6	5.6	5.5	5.2
Interest payments Public sector consumption*	18.3	18.5	18.5	18.3	17.9

* in % of GDP. The estimate is based on the data contained in the convergence programmes submitted by the Member States and on a number of assumptions. (II-396-93, pp. 20-25).

OPINION
of the
Economic and Social Committee
on
Monetary Policy

Procedure

On 24 February 1994, the Economic and Social Committee decided, in accordance with Article 20, 4th paragraph of the Rules of Procedure, to issue an Initiative Opinion on

Monetary Policy.

The Section for Economic, Financial and Monetary Questions, which had been instructed to carry out the preparatory work, adopted its Opinion on 6 September 1994. The Rapporteur was Mr MEYER-HORN.

The Committee unanimously adopted the following Opinion at its 318th Plenary Session (meeting of 15 September):

Mandate

The Economic and Social Committee decided to draw up an Initiative Opinion on Monetary Policy, as the ESC wished to express its views on the realization of Economic and Monetary Union, even though consultation of the Committee is not mandatory. Monetary policy is of great importance for the recovery and convergence of the Member States' economies, and thus for the transition to Economic and Monetary Union (EMU) scheduled for 1999 at the latest. Experience of institutionalized cooperation between central banks in the European Monetary Institute since early 1994, and progress on the preparations for a common monetary policy will be taken into account at the intergovernmental conference scheduled for 1996 and in any revision of the Maastricht Treaty on European Union.

1. Monetary policy during the second stage of EMU against the background of the recession

1.1. Monetary policy, whether during the second stage of EMU or thereafter, cannot be seen in isolation. It is not an objective in itself, but rather a component of economic policy - designed where possible to promote steady growth of national output, to create and safeguard jobs, and at the same time to prevent inflation. In the EU, economic policy is also geared to economic convergence (Art. 103(3) Treaty on European Union), eventually leading to economic and monetary union, without which the advantages of the internal market cannot be fully exploited.

1.2. Under Article 109j(4) of the version of the EEC Treaty adopted at Maastricht, the third stage of EMU is to begin on 1 January 1999, if no earlier deadline is set. At the starting date of the third stage, the Council will adopt the conversion rates at which the currencies will be fixed and at which rates they will shortly afterwards be replaced by the ECU (Article 109(I)(4). A mere four years before the 1999 deadline, however, public interest is focused on mass unemployment and the persistent recession, rather than on feverish preparations for monetary union. A Eurobarometer (40 - 12/93) opinion poll showed that for 67% of respondents, unemployment was the major problem; inflation and exchange rate instability were considered the main problems by only 9 and 10% respectively.

1.3. Even in 1991 during negotiations on the inter-governmental conference considerable doubt was expressed as to the feasibility of EMU. Would it be possible:

- on the one hand to transfer a future common monetary policy to an independent European central bank;
- and on the other, to leave economic and financial policy with the national governments, subject only to coordination in the ECOFIN Council in accordance with common guidelines and without a joint economic and financial policy adopted by some form of "European government"?

1.4. The most severe recession of the second half of this century and (partly structural) mass unemployment have given rise to new doubts about the EMU decided at Maastricht:

1.4.1. Is there not a contradiction between a) the economic and financial policy needed to cope with 17 million unemployed and b) that dictated by convergence in preparation for EMU?

1.4.2. Does the reaction[7] to the Commission's White Paper[8] on Growth, Competitiveness and Employment not show how differently these challenges are assessed, e.g. in relation to the investment of ca. ECU 400 bn. in trans-European transport, telecommunications and energy networks in the period to 1999?

1.4.3. Can twelve, and perhaps soon sixteen, Member States regularly reach consensus on the coordination of their economic policies? Can such a consensus be expected after the experience with the first broad economic policy guidelines recommendation of December 1993[9], and in particular the Commission's recommendation that the Community should aim to create 15 million jobs by 2000 and thus to halve the present rate of unemployment (1994: 12%)?

1.4.4. Does the prospect of a European Council Decision (under Articles 109g and h of the EEC Treaty) to establish EMU with only half the Member States not threaten to split the Community? Do the convergence requirements of the second stage not already expect too much of Member States with relatively low incomes? Are the resources to be made available from the Structural and Cohesion Funds a

[7] Cf. the ESC's Opinion on the economic, social and industrial aspects of the White Paper: CES 750/94, CES 751/94 and CES 752/94.

[8] Cf. COM(93) 700 final of 5 December 1993.

[9] See Commission Framework of 10 November 1993, Commission Recommendation of 24 November 1993, Council Recommendation of 22 December 1993, based on the Conclusions of the European Council of 10/11 December 1993, in European Economy 55/94.

suitable way of bolstering efforts by these countries to make progress on real as well as nominal convergence?

1.4.5. In view of these doubts should the deadline for EMU not be postponed and the convergence criteria relaxed to reflect the deterioration in economic circumstances?

1.5. The doubts expressed in point 1.4. have prompted the ESC to supplement its October 1993 Opinion[10] on policies to be pursued in the Community during the transitional stage of EMU with this Opinion on monetary policy. The ESC asked how, against the background of the recession, monetary policy could be coordinated and an EMU with a single currency be prepared; it came to the following conclusion.

1.5.1. If economic policies are not now harnessed to launch an energetic and urgent assault on unemployment, the result may be a situation which leaves Economic and Monetary Union looking utopian. If the economic policy required by the recession is properly coordinated, it need not automatically run counter to convergence policies required for the preparation of EMU.

1.5.2. The convergence programmes must be adjusted to reflect the recession and be developed into convergence-and-recovery programmes. With mass unemployment and recession, greater efforts must be made to coordinate economic and monetary policy in the Community, to observe the common guidelines and to strengthen multilateral surveillance. A new recommendation on broad economic policy guidelines (see point 1.4.3.) could place more emphasis on active support of economic growth, without however neglecting the medium-term objectives of convergence policy[11]. With the Internal Market and freedom of capital movements largely in place, economic interdependence and interpenetration is so great that any Member State which goes it alone on economic and monetary policy hurts both itself and its neighbours.

1.5.3. For the ESC, merely softening the convergence criteria is no solution. An adjustment of this kind is not even necessary as the convergence criteria are to some extent relative, i.e. related to the Member States with the best relative performance (Article 109j(1)) or open to interpretation (Article 104c(2)). Moreover, GDP must also be calculated in a uniform and reliable manner; taking account of the black economy poses problems. It has been demonstrated that the recalculation of GDP, Portugal's for instance, would enable the government debt/GDP criterion to be met. Closer cooperation on statistics is therefore particularly important[12].

1.5.4. Adjustment of the convergence criteria would also have the twofold disadvantage that:

- confidence in the feasibility of EMU, already diminished, would be further undermined, and

- efforts to achieve convergence would be relaxed.

1.5.5. In some countries, the budget convergence criteria can in the present recession only be given medium-term priority. In a recession, the budgetary criteria should not trigger or even be used as a pretext for, economic measures which are likely to exacerbate the crisis even further. An excessively tight interpretation of the budget policy criteria could reduce the scope for cyclical fine tuning and would reinforce the cyclical downturn rather than counter it. On the other hand, the unavoidable new borrowing required to finance extraordinary expenditure should be limited because of the already considerable burden imposed by debt servicing on the budgets of some Member States. It should be borne in mind, however, that gradual reduction of budget deficits and government debt would place a heavy burden on these Member States in the run-up to EMU. (See point 3.1.4.).

1.5.6. The convergence criteria are important mainly because they have been, and are, interpreted as a quality standard for the future monetary union, a guarantee of monetary stability, which the Maastricht Treaty makes the main plank of the European Central Bank's monetary policy. Most Member States endorsed the Maastricht Treaty because of this confidence in the stability of a European currency (see point 4.2.4.). The ESC shares the view[13] that the Member States' policy and behaviour up to 1996 should be consistent with the objective of an inflation rate of no more than 2 to 3%. Lack of such coherence would constitute a major macroeconomic obstacle to growth, overload monetary policy and make it necessary to pursue the stability objective by means of high interest rates.

2. The institutional framework of monetary policy

2.1. Role and responsibilities of the EMI

2.1.1. The EU Treaty does not give the EMI any monetary policy responsibilities of its own, correctly the ESC feels, as there would otherwise be conflicts of interest in view of the fact that, during the second stage, responsibility for monetary policy will continue to rest exclusively with the central banks. The possibility of the central banks coordinating their monetary policy to a limited extent via the EMI towards the end of the second stage should be considered however. Intervention on foreign exchange markets and common money supply targets would be possible areas for joint action.

2.1.2. **Foreign exchange market intervention** by the EMI would however require the national central banks to transfer some of their foreign exchange reserves to the EMI and the Central Banks to agree in the EMI Council on a common exchange rate policy. This would, however, be difficult because of the possible need for further parity adjustments in the event of different rates of progress on

10 ESC Opinion, OJ No. C 352 of 31 December 1993, pp. 3-8.

11 see CES 750/94 of 1 June 1994, point 2.2.7.

12 See ESC Opinion of 27 April 1994, OJ No. C 195 of 18 July 1994, p. 1.

13 European Economy 55/93, foreword, paragraph 6.

convergence and in view of the varying extent to which Member States have used the wider (ERM) fluctuation band of 15% either side of the parity, introduced on 2 August 1993.

2.1.3. The establishment of ***common money supply targets*** by the EMI could be considered by the central banks as an additional, non-binding guideline. But the money supply is defined and calculated differently from one Member State to another. The central banks of the Member States do not all attach the same importance to the money supply as a component of monetary policy. The monetary policy of some central banks is aimed, rather, primarily at the exchange rate and/or interest rates. In some countries, money supply targets are even regarded as an obsolete criterion. In others control of government debt is considered to be of particular importance for monetary policy.

2.1.4. The initial joint monetary policy measures through the EMI would require it to carry out the tasks allocated to it[14] successfully, i.e. strengthening cooperation between the national central banks and coordinating their monetary policies with the aim of promoting price stability and taking over the tasks of the European Monetary Cooperation Fund (EMCF) and monitoring the functioning of the EMS.

2.1.5. The EMI also has statutory responsibility for preparing the third stage of EMU, in particular: promoting the efficiency of cross-border payments[15], drafting the rules for operations to be undertaken by the national central banks in the framework of the future European system of central banks (ESCB) and promoting cooperation on statistics[16] in areas within its field of competence. The ESC feels that the EMI should also promote cooperation on banking supervision, which is partly the responsibility of the central banks themselves and partly that of independent supervisory authorities, to some extent separately from credit insurance and the securities markets. With regard to cooperation on banking supervision, common initiatives should in particular be looked at to bring derivatives transactions within the scope of supervision (see point 4.2.7.).

2.1.6. The ESC sees the EMI's two most important tasks as the coordination of the monetary policies of the participating central banks (see point 2.2.) and the preparation of the instruments and procedures needed for carrying out a single monetary policy (see point 4.5.).

2.1.7. The ESC feels that the EMI should provide the public with timely, comprehensive and comprehensible information on two of its other statutory responsibilities:

- supervising the technical preparation (design, denominations) for the issue of approx. ECU 15 billion banknotes and 100 billion coins, and

- facilitating the use of the ecu.

2.1.7.1. The ESC refers to its suggestion[17] that when the time is ripe, the national media should be enlisted in order to provide a comprehensive explanation of EMU, and in particular the replacement of national currencies by a single currency, the ecu, and to boost confidence in the new system. The introduction of the ecu as a currency will mean an unprecedented adjustment to a completely new structure of prices and incomes in all the participating Member States; expressed in national currencies one ecu will be equivalent to an amount ranging from four places before the decimal point to four places after the point; in no case will the conversion rate be a round figure.

2.1.7.2. Reports should be published by the EMI and its competent working party to keep the public informed on the progress of the discussions on the design of the new ecu banknotes. Unlike format and paper quality, design is not something which can be decided behind closed doors.

2.1.7.3. The ESC believes that ecu banknotes should be identical in all the Member States. Each denomination could feature front and back a different national, but universally familiar, figure from science or the arts, or a national monument; in this way each Member State would be represented on at least one of the eight banknotes (e.g. 1, 2, 5, 10, 20, 50, 100 and 200 ECU). This approach would reflect Europe's common cultural heritage. The appearance of the ecu banknotes must not remain a secret until 1999, however.

2.2. Coordination

2.2.1. The ESC expects monetary policy cooperation to be stepped up between the national central banks within the institutional framework of the EMI, i.e. over and beyond the cooperation which already took place in the EC Committee of Central Bank Governors. Without step-by-step closer cooperation in the second stage, it is difficult to imagine that a European Central Bank would be able to operate a single monetary policy from the beginning of the third stage.

2.2.2. The practical coordination of monetary policy is even more important than its legal framework. Coordination will of course be made more difficult by the fact that:

- the central banks will guard their monetary policy responsibility and independence jealously until the end of the second stage;

- it is impossible to imagine an overnight transition to a common monetary policy under the aegis ECB.

The central banks ought therefore to confer as frequently as possible, and certainly before all major decisions. The EMI is the appropriate forum for this. In addition to these, generally informal, coordination meetings, the central bank governors should meet regularly, perhaps every two weeks, for a session of the EMI Council. This is essential if the central bank governors are to be able to as-

14 See Protocol 4 annexed to the EU Treaty, Articles 4, 5 and 7.

15 See ESC Opinion of 6 July 1994 (CES 854/94).

16 See ESC Opinion of 27 April 1994, OJ No. C 195 of 18 July 1994, p. 1.

17 See ESC Opinion, O.J. No. C 34, 2 February 1994, pp. 25-35.

sume responsibility for a common European monetary policy at the beginning of the third stage, in their capacity as members of the ECB Council. Successful coordination of monetary policy, which in the second stage will still be nationally based, will depend on the willingness of the central banks to be guided increasingly by Community objectives, in particular with regard to price stability.

2.2.3. The EMI should use its, albeit non-binding, opinions and recommendations frequently and at an early stage to contribute to closer cooperation between the central banks and the coordination of their monetary policies. Opinions and recommendations are adopted by the EMI Council by a two-thirds majority. Unanimity is required for the publication of opinions and recommendations. The ESC feels that such opinions and recommendations, if not published, should at least be commented on by the EMI Chairman. The EMI will secure the credibility and public confidence it needs in its activities as a precursor of the European Central Bank by issuing well founded opinions and recommendations[18] based on thorough analysis.

2.2.4. The ESC welcomes the arrangement whereby the President of the ECOFIN Council and a member of the Commission may attend the meetings of the EMI Council, and under which the Chairman of the EMI will be invited to meetings of the ECOFIN Council when it discusses matters falling within the EMI's area of responsibility. This reciprocal participation, provided for in Article 11 of the EMI statute, would appear appropriate.

3. The relationship between monetary policy and economic policy coordination

3.1. Recommended economic policy guidelines

3.1.1. In parallel with closer cooperation between the central banks and coordination of monetary policy, the Member States's economic policies must also be more closely coordinated. The success of monetary policy will depend on the successful coordination of economic policies. The central banks' monetary policy will be overloaded and coordination of policy in the EMI hampered if monetary policy is expected to remedy the mistakes and shortcomings of economic policy in general and budgetary policy in particular. On the other hand, reducing budget deficits and government debt in line with the budgetary policy convergence criteria will facilitate monetary policy, as it will lay the foundations for a further reduction of the inflation rate and for lower interest rates, thus fulfilling two other convergence criteria.

3.1.2. On 22 December 1993 the ECOFIN Council adopted, in the form of a recommendation, the broad guidelines of economic policies as defined in Article 103(2) of the EU Treaty. These broad guidelines will serve to gear national economic policies towards Community objectives. One of these is achieving sufficient convergence between the economies for the transition to the third stage.

3.1.3. The ESC welcomes the fact that the guidelines are from now on to be reviewed and adjusted in mid-year, before the budget for the following year is adopted. The guidelines of 22 December 1993 include important measures from the White Paper (growth, competitiveness and employment) submitted by the Commission to the European Council on 10 December 1993[19].

3.1.4. The economic policy guidelines of 22 December 1993[20], which were reaffirmed by the ECOFIN Council on 11 July 1994, include efforts held by the Member States to prevent any further deterioration in their budgetary situations in 1994 and to achieve budget consolidation. In 1995 they are required to pursue action to make their public finance positions sustainable again. The ESC welcomes these recommendations. It points out however that some Member States will need more time than others to consolidate their budgets. They may not be able to fulfil the 22 December 1993 conditions until after 1996.

3.2. Multilateral surveillance and the convergence programmes

3.2.1. The coordination of economic policy, compliance with the guidelines referred to in point 3.1.2. by the various Member States and the implementation of their convergence programmes are all to be the subject of **multilateral surveillance**[21]. Apart from the initial economic policy guidelines, the ESC feels that two innovations in the second stage will improve multilateral surveillance:

3.2.1.1. The ECOFIN Council, acting by qualified majority, may decide to make public its recommendations to individual Member States in connection with multilateral surveillance (Art. 103(4) EU Treaty).

3.2.1.2. On a proposal from the Commission, the ECOFIN Council may adapt the multilateral surveillance procedures to the requirements of economic policy coordination (Art. 103(5)).

3.2.2. The ESC has already commented on the new procedure provided for in Article 103 of the EEC Treaty in its Opinion on the 1994 Annual Economic Report[22]. The ESC regrets that the old consultation requirement has been dropped. It is particularly important that the economic and social groups represented in the ESC be consulted on the issues of monetary stability, employment, investment and production costs, which are dealt with in the Annual Economic Report, the country reports it produces and the broad economic policy guidelines.

3.2.3. In accordance with the decision of the ECOFIN Council of 8 July 1991, most governments drew up **convergence programmes** at the beginning of the second stage. The convergence programmes list the measures whereby the Member States hope eventually to be able to meet the

18 See Hearing of EMI Chairman Lamfalussy by the European Parliament on 10 November 1993.

19 The ESC has adopted Opinions on the subject - see footnote 1.

20 European Economy 55/1993, Part A, I, Point 2.2. and No. 58/1994.

21 Decision 90/141 EEC, OJ No. L 78 of 24 March 1990.

22 ESC Opinion of 27 April 1994, OJ No. C 195 of 18 July 1994, pp. 44-52 point 6.

convergence criteria for transition to the third stage. The ESC considers that the convergence programme must be adjusted to reflect economic conditions and be developed into convergence - and - recovery programmes[23]. The ECOFIN Council assesses the convergence programmes submitted to it in restricted session. Only a summary of the results of the discussions is made public. The ESC regrets this.

3.2.4. The ESC considers that national convergence and recovery programmes should not be drawn up in isolation, but rather on a coordinated basis. Cooperation between Germany and France on drawing up their respective programmes is an initiative to be welcomed. In this way the possible repercussions of national measures on other Member States can be better assessed and taken into account in the convergence programmes, whose timescales should as far as possible be coordinated.

3.2.5. All the convergence programmes[24] require deficits to be reduced in the medium term and the reference value of 3% of GDP to be achieved by 1996. Government debt, which rose from an EC average of 58% in 1991 to 66.4% in 1993, is first to be stabilized, and then reduced. The ESC welcomes these ambitious objectives, but wonders whether the political will exists everywhere actually to put the convergence programmes into effect; this would certainly be desirable.

3.2.6. The ESC feels that the procedure for pursuing convergence programmes after the beginning of the third stage should be decided now. In so doing, thought should be given a) to the continuation of the convergence programmes for those Member States not participating in the currency union from the beginning and b) their coordination with the countries forming the ecu zone. This would make it easier for the first group of Member States to join the ecu zone at an early stage.

3.2.7. Under Article 104c(6) the ECOFIN Council decides whether an excessive deficit exists and makes recommendations to the Member State concerned with a view to bringing that situation to an end within a given period. If no effective action is taken, the recommendations may be made public. The ESC expects that the excessive deficit procedure will be invoked only where an overshoot of the reference value is not purely a result of the recession and mass unemployment. On the other hand, compliance with the prohibition on deficit financing by central banks and on privileged access for the public sector to financial institutions should be enforced.

3.2.8. Because of the scale of the recession most Member States will not be immediately able to meet both budgetary convergence criteria[25]. In 1993 eleven Member States exceeded the deficit criterion and seven the debt criterion; only Luxembourg fulfilled both criteria.

3.2.9. The budgetary problems of most Member States make it more difficult to pursue a monetary policy aimed at price stability. This in turn adversely affects the relationship between the central banks working together in the EMI, and in particular between the central banks which are already independent on the one hand, and the economics and finance ministers meeting in the ECOFIN Council on the other.

3.2.10. The ESC feels that the EU's **Monetary Committee** (established under Article 109c) could play an important role here, as its membership includes senior representatives of the central banks, the finance ministries and the Commission. Differences between the ECOFIN Council and the EMI on economic and monetary policy and their coordination could be thrashed out and eliminated at the Monetary Committee stage. The ESC feels that the Monetary Committee holds the key to the desired progress on coordination, both of economic policy and monetary policy. If no consensus is achieved in the Monetary Committee neither the ECOFIN Council nor the EMI Council will be able to work for coordination where obstacles exist.

3.2.11. In its Maastricht Declaration[26] the Community affirms its intention of contributing to stable international monetary relations. To this end the Community is prepared to cooperate with countries with which it has close economic ties. Under the Agreement (Article 46) on the European Economic Area (EEA), the EU intends to discuss common problems of economic and monetary policy with its EEA partners. The ESC is pleased to note that the meetings initiated in April 1993 are in future to be held twice a year.

4. Major areas of mmonetary policy cooperation

4.1. The EU, the G7 and the OECD

4.1.1. The major areas of cooperation between the central banks in the EMI include securing price stability, EMS exchange rate policy, interest rate policy and the approximation of monetary policy instruments and procedures.

4.1.2. Monetary policy cooperation in the EMI must also take account of economic trends in the main industrialized countries, the Group of Seven and the OECD, with which most EU countries have close trading relations. In particular, the reaction to trends in the exchange rates of the US dollar and the yen must be as far as possible coordinated.

4.1.3. It would facilitate the EU's monetary policy if the USA were, in the framework of its otherwise highly successful economic policy, to make efforts to cut its budget deficit and if the Federal Reserve Bank were not to raise its discount rate any further. The Congressional Budget Office (CBO) has estimated that US government debt is rising faster than national income. Government debt is forecast to more than double as a proportion of GDP within a genera-

23 See Opinion on policy during the transitional stage of EMU (OJ No. C 352 of 30 December 1994, pp. 3-8, points 1.1.2. and 2.2.2.1.).

24 European Economy 55/1993, Part B, I, Point 2.2.2. and tables 3 and 7.

25 Under Article 104(c)(2)(a) budget deficits may not exceed 3% of GDP. Under Article 104(c)(2)(b) government debt may not exceed 60% of GDP.

26 Fifth Declaration appended to the Final Act of the EU Treaty.

tion. This far-reaching projection is based on the fact that over half of government spending is currently required by law, i.e. social security, and in particular pensions and medical cover, and that demographic trends will cause this spending to continue to rise. The USA faces similar problems to some EU Member States; i.e. it must attempt to curb its budget deficit rather than simply raising interest rates. Because of the dollar's importance for payments in international trade, for the currency markets and for central banks' reserves, the US budget deficit and interest rate adjustments have a direct impact on the monetary policy environment for the EU and its Member States. A successful US budget policy would thus benefit the monetary policy of the EU and its Member States.

4.2. Price stability

4.2.1. The primary objective of monetary policy (under Art. 105(1)) is the maintenance of **price stability**. Monetary policy will also support general economic policies in the EU, without prejudice to the objective of price stability.

4.2.2. In 1993 the average inflation rate in the EU was 3.8%. The four countries with the lowest inflation rates were Denmark with 1.4%, the Netherlands with 2.1%, and France and Ireland each with 2.3%. Under the convergence criterion, the inflation rate in the other Member States should not have been more than 1.5% higher. In fact, five Member States had an inflation rate above 3.8%[27], including Germany with 4.3%, Italy with 4.4.% and Spain with 4.7%.

4.2.3. In its broad economic policy guidelines the Community sets itself the objective[28] of achieving an annual inflation rate not higher than 2-3% in most of the Member States by 1996. All economic policy and behaviour should be consistent with this objective.

4.2.4. The Commission believes[29] that an inflation rate not higher than 2-3% is in keeping with a monetary policy stability target which is not usually spelt out explicitly. This seems realistic as an initial objective. The ESC believes that an average Community inflation rate of 2-3% can be achieved as early as 1995, although admittedly more as a result of the recession than of the central banks' monetary policies. This is not entirely satisfactory from the saver's point of view. The ESC would like to see the Council of the EMI, regardless of the then prevailing average inflation rate, specifically recommend an ambitious monetary policy stability target for the ecu before the third stage, offering the prospect of a stable common currency within a monetary union.

4.3. Exchange rate policy

4.3.1. The Council Recommendation of 22 December 1993 stated that the high degree of integration and the reaping of the benefits of the internal market demanded that the Community continue to aim for exchange rate stability built on common efforts to make progress on convergence[30].

4.3.2. The Commission has established[31] that the Member States have not made use of the greater potential to differentiate their monetary stance offered by the temporary widening since 2 August 1993 of the EMS exchange rate mechanism's fluctuation bands to 15% either side of the parity. Instead, after some major rate adjustments in the wake of the foreign exchange market turbulence of July 1993, they have maintained their commitment to monetary policy cooperation based on stable exchange rates and have pursued a "cautious" interest rate policy. As a result, since the beginning of 1994, exchange rate movements have in effect been limited[32] to a fluctuation margin of less than 4.5%.

4.3.3. In its Opinion of 24 November 1993[33], the ESC argued that the central banks should, through the EMI, continuously monitor the extent to which the wider fluctuation bands are actually being used. On this basis the ESC felt that a timescale for gradual coordinated narrowing could be considered.

4.3.4. The ESC welcomes the Commission's assessment contained in its convergence report, submitted in accordance with Article 109(1)(2)b[34]. The text reads as follows: "Any effort to re-establish narrow bands without improved economic convergence among Member States would almost certainly not be accepted by the financial markets and would incite renewed speculative attacks on the ERM grid. The experience of the recent crises has demonstrated that a necessary condition for exchange-rate stability is achieved by the pursuit of credible and consistent economic policies designed to foster economic convergence in conditions of economic growth, while focusing on the fundamentals of price stability and sound public finances."

4.3.5. Art. 109j(1) of the EU Treaty states as a third convergence criterion: "the observance of the normal fluctuation margins provided for by the Exchange Rate Mechanism of the European Monetary System, for at least two years, without devaluing against the currency of any other Member State." The EMI should perhaps decide what is to be considered as "normal" with a view to the third stage of EMU following the "temporary" widening of the fluctuation margins on 2 August 1993. In this connection, the view[35] that the reintroduction of a general, narrow fluctuation band is no longer an absolute precondition for transition to the third stage of EMU, is particularly striking. The ESC considers the "normal fluctuation margins" referred to in Article 109j(1) as a concept which need not yet be quantified.

4.3.5.1. Retention of the "temporarily" widened fluctuation margins reduces speculative pressure on the ERM grid and makes it possible for exchange rate adjustments necessitated by divergent progress on convergence to be carried

27 European Economy, No. 55/1993: Broad economic policy guidelines and convergence report, Part B, table 1.

28 European Economy, No. 55/1993, part A, I and II, point 2.1. and No. 58/94.

29 European Economy, No. 55/1993, part A, III, point 2.1.

30 European Economy, part A, I, point 2.1.

31 European Economy No. 55/1993, part A, III, point 2.1.

32 European Economy No. 55/1993, part B, I, point 2.2.5 and table 53.

33 OJ No. C 34 of 2 February 1994, pp. 23-25, point 1.4.10.

34 European Economy No. 55/1993, part B, I, point 2.2.5., p. 7.

35 Financial Times, 27.10.1993.

out without drama[36]. The general retention of the "temporarily" widened margins does not prevent individual central banks agreeing among themselves on narrower fluctuation margins for their currencies, as has already been done in the case of the German mark and the Dutch guilder.

4.3.5.2. The retention of the wider margins would also make it easier for the Italian lira and pound sterling to rejoin the ERM, and for the Greek drachma finally to join, the ERM. The EMI can play a constructive role here through its recommendations and opinions, and through proposals for improved application of the EMS rules capable of commanding consensus support. In the framework of the EMI a general lesson can be learnt from the EMS crises, namely that the EMS should again be regarded as a system of fixed, but adjustable exchange rates.

4.3.6. A once again fully operational EMS exchange rate mechanism would not only facilitate transition to the third stage of EMU, but would also prevent the damaging effects of parity changes on common farm prices.

4.3.7. In the context of exchange rate policy, a coordinated EMI initiative should be considered to bring derivatives within the scope of banking supervision. The banks' off-balance-sheet transactions in futures, options and swaps often exceed their balance sheet totals. And yet prudential controls such as solvency or liquidity ratios do not as yet extend to derivatives transactions. Bringing derivatives under the Member States' banking supervision - if possible in concert with the OECD countries - would reduce the volume of speculative monetary movements on the foreign exchanges, or at least curb their growth.

4.3.8. For the reasons set out above, the coordination of exchange-rate policy in the EMI is one of the main tasks for monetary policy. This task will be facilitated if:

- the signs of recovery of economic growth are confirmed,

- in particular, unemployment can be reduced; (here the Commission's White Paper has proposed important measures for the creation of fifteen million new jobs), and

- in general, further progress is made on price stability, as is already suggested by the fall in the average Community inflation rate from 5.3% in 1991 to 3.8% in 1993.

4.3.9. Under these conditions the EMI can afford to be less concerned about possible unilateral national monetary policy action and look forward with greater confidence to generally more stable exchange rate relationships.

4.4. Interest rate policy

4.4.1. The Commission[37] rightly notes progress on convergence of long-term interest rates. Between 1990 and 1993 average long-term interest rates in the Community fell from 11.0% to 8.1% and the reference band from 11-13% to 8.7-10.9%. The fall in interest rates was accompanied by an improvement in convergence: in 1993 only two countries were above the reference band, as against four in 1990; seven countries were below the reference band, compared with five in 1990. The interest rate spread has thus narrowed.

4.4.2. Measuring convergence on interest rate policy is made more difficult by the fact that reported interest rates are determined differently. The Commission's draft Regulation on Community action in the field of statistics will improve matters. The ESC welcomes this in its Opinion[38].

4.4.3. These cautious interest rate cuts demonstrate two things:

- that progress towards lower inflation has created a sounder basis for cuts in short and long-term interest rates;

- that the scope for differentiated monetary policy created by the widening of the EMS fluctuation margins has not led to precipitous interest rate cuts.

One may therefore hope and expect that closer monetary policy cooperation in the EMI will lead to further interest rate convergence.

4.4.4. The respective importance of short and long-term interest rates varies from one economy to another. This is explained by the varying approaches to financing the banking system, the use of debt finance by the public sector and the open market policies of the central banks. One much quoted example is the different approach to financing home ownership/building in Great Britain and Germany. The predominance of short-term finance in Britain has a greater impact on short-term interest rates there than in Germany, where housing loans are made at long-term interest rates, financed mainly by the issue of special long-term debt instruments ("Pfandbriefe"). Closer cooperation between central banks on interest rate policy is hampered by differences of this kind (See point 4.5.3.).

4.5. Monetary policy instruments

4.5.1. The EMI must as a matter of priority work for approximation of monetary policy instruments and procedures. The monetary policy of the central banks places differing emphasis on the classical instruments of discount, open market and minimum reserve policy. Moreover, these instruments and procedures differ from one country to another.

4.5.2. Step-by-step approximation is necessary not only in preparation for the single monetary policy to be adopted with the beginning of the third stage of EMU. The degree of integration achieved with the completion of the internal

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36 See ESC Opinion of 24 November 1993, OJ No. C 34 of 2 February 1994, pp. 25-35, point 1.3.2.2.

37 European Economy No. 55/1993, part B, I, point 2.2.4. and table 9.

38 See ESC Opinion of 27 April 1994 on COM(94) 78 final of 10 March 1994, OJ No. C 195 of 18 July 1994, p. 1.

market also makes a certain approximation of monetary policy instruments necessary, in particular with regard to financial and capital movements and the growing cross-border activities of credit institutions and insurance companies.

4.5.3. In the field of open market policy, the range of money market paper, treasury bills, treasury bonds and other securities issued and purchased by the central banks in order to influence the liquidity of the banking system, and to some extent that of the whole economy, needs to be brought into line rapidly. A gradual approximation of the maturities of central bank open market liabilities and of securities taken on deposit and lent on by the central banks is of great importance. This would lessen the remaining differences in the impact of interest rate policy based on the discount rate from one country to another. This disparity is clearly illustrated by the different impact of discount rate adjustments in Great Britain and in Germany (see point 4.4.4.):

- in Great Britain the short-term interest rate has an immediate impact on credit which is mostly financed short term;
- in Germany a higher proportion of loans are refinanced longer term by the issue of mortgage bonds (Pfandbriefe), municipal or bank bonds and other securities with maturities of ten years or more. The short-term interest rate, and discount rate adjustments by the Bundesbank, thus do not have the same impact as in Great Britain.

4.5.4. For the purposes of the interest-rate and open-market policy of a European central bank, intended to apply evenly throughout the Community, it would be a good thing to have convergence in the use of these monetary policy instruments during the second stage. This is also true of the central banks' minimum reserve policies. In its Opinion of 24 March 1993[39] the ESC compared the different extent to which credit institutions are affected by the requirement to maintain (generally interest-free) minimum reserves with the central bank and by compulsory investment in securities. These differences, now less pronounced, lead to distortions of competition in the financial sector and to transfers of banking activity to countries with lower minimum reserve requirements, or none at all. The requirement still imposed by central banks on credit institutions in some Member States to buy government securities continues to affect competition in cross-border banking. Such a requirement is also in contravention of the ban on the financing of public-sector deficits via the central banks.

4.5.5. In addition to the monetary policy instruments and procedures, the parameters also need to be approximated. The main benchmark in most Member States is money supply trends. But this is differently calculated and defined, e.g. with regard to the inclusion of savings accounts and term deposits. The EMI should therefore make proposals for a common definition of money supply (M1 or M2) and for its uniform statistical calculation[40]. As the next step, the EMI could consider ways of achieving agreement between the central banks on attaching comparable weight to money supply targets in the second stage, and finally on a certain approximation of money supply targets or margins (see point 2.1.3.).

4.5.6. Approximation of monetary policy instruments and procedures presupposes preparation for a single monetary policy. Drawing up a plan acceptable by consensus during the second stage is an important task for the EMI.

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39 See OJ No. C 129 of 10 May 1994, pp. 10-17).

40 See ESC Opinion on COM(94) 78 final of 10 March 1994, OJ No. C 195 of 18 July 1994, p. 1.

OPINION

of the

Economic and Social Committee

on the

Communication and Draft Proposal for a Directive on the Transparency and Performance of Cross-Border Payments

(SEC(93) 1968)

Procedure

On 22 April 1994 the Economic and Social Committee decided, in accordance with Article 20(4) of its Rules of Procedure, to draw up an Opinion on the

Communication and Draft Proposal for a Directive on the Transparency and Performance of Cross-Border Payments
(SEC(93) 1968 final).

The Section for Economic, Financial and Monetary Questions, which was responsible for preparing the Committee's work on the subject, adopted its Opinion on 14 June 1994. The Rapporteur was Mr MEYER-HORN.

At its 317th Plenary Session (meeting of 6 July 1994) the Economic and Social Committee adopted the following Opinion with one vote against and five abstentions:

1. Preliminary Remarks

1.1. Under pressure from the Commission, the European credit sector associations (ECSAs)[41] prepared guidelines for customer information on cross-border payments which, after consultations with the Commission and its Payment Systems Users Liaison Group (see point 1.3) were submitted in March 1992. The Commission suggested that these guidelines be implemented by the banks by the end of 1992, obviously with an eye on the deadline for the implementation of the single market. The associations thereupon declared themselves ready to work towards having the guidelines applied by their member institutions as soon as possible. To the guidelines was appended a Commission working document entitled "Easier Cross-Border Payments: Breaking Down The Barriers"[42] in which the Commission stated it would monitor the guidelines' implementation.

1.2. To do this the Commission ordered a study to be carried out in February 1993 which looked at:

- the quality of the written information given in 287 bank branches to customers wishing to make a cross-border payment; and
- the actual performance of carrying out around 1,000 transfers of ECU 100 each between accounts with 34 banks in all Member States.

1.3. The study's findings were discussed in September and October 1993 in two Commission advisory groups:

- the Payment Systems Technical Development Group (PSTDG); and
- the Payment Systems Users Liaison Group (PSULG).

Both advisory groups had already expressed their views on the implementation of the 1990 Commission Recommendation on the transparency of banking conditions relating to cross-border financial transactions (90/109/EEC, OJ L 67 of 15 March 1990, page 39). The PSULG discussed and agreed with the guidelines referred to in point 1.1.

1.4. The study's findings and the advisory groups' Opinions on them were summarized in a Communication to the Commission on Transparency and Efficiency in the Performance of Cross-Border Payments[43]. In this Communication the Commissioners responsible, Mr VANNI d'ARCHIRAFI and Mrs SCRIVENER, suggested the following line of action, which was approved by the Commission on 14 December 1993.

1.4.1. The banking industry would be given a further deadline for achieving the desired results in terms of transparency and performance through self-regulation.

1.4.2. The Commission would examine the progress made before August 1994 by conducting a second and definitive study in March/April 1994, which would be submitted at the end of July.

1.4.3. As a precaution, a draft proposal for a Council Directive on Transparency and Performance of Cross-Border Payments would be prepared. If insufficient progress had been made in this field, the Commission would immediately initiate legislative action in the form of a Directive. A first draft proposal for such a Directive was attached to the Communication. Since April 1994 this draft Directive has been under examination by the Commission working party of government experts.

1.4.4. Finally the Commission began talks in the PSULG (see point 1.3.) about guidelines in which the fullest possible instructions about "face-to-face" payments are to be laid down[44]. This covers cross-border payments which customers of a credit institution in a Member State arrange themselves by means of a card or cheque while they are in another Member State. It remains to be seen to what extent guidelines on what information should be given to customers before and after face-to-face payments may supplement the "Code of Best Practice"[45] drawn up by the three ECSAs on 14 November 1990.

1.5. The ESC has general and specific comments to make in chapters 2 and 3 below on:

- the Communication to the Commission and the studies referred to in it, together with the Opinions of the PSTDG and PSULG; and
- the first draft proposal for a Council Directive appended to the Communication, which is to be enacted in the light of the Opinions of the European Parliament and the Economic and Social Committee.

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41 The Banking Federation of the European Community, the European Savings Banks Group and the Association of Cooperative Banks of the EC.

42 SEC(92) 621 of 17 March 1992.

43 SEC(93) 1968.

44 See Commission document XV/106/94.

45 Code of Best Practice of the European Banking Industry on Card-Based Payment Systems (doc. 135/90).

2. General Comments

2.1. The ESC welcomes the attempts of the Commission and the credit industry to improve the cross-border payments market, as regards:

- the transparency of conditions; and
- the speed, reliability and costs of such operations.

The ESC regrets that these attempts were not undertaken earlier and that the 1990 Commission Recommendation referred to in point 1.3 has been put into effect so late.

With the completion of the internal market in 1993 and the transition to an economic and monetary union by no later than 1999 scheduled by the Maastricht Treaty, cross-border payments, especially large-scale transfers of smaller amounts, are becoming increasingly important. The ESC therefore thinks it is of pressing importance that cross-border transfers become more transparent and efficient and that the steps still necessary to this end be taken soon (see point 2.9).

2.1.1. According to the Banking Federation of the European Community (1991 and 1992 Annual Reports), cross-border transfers by cheque, transfer or cards totalled some 323 million in 1990 and around 398 million in 1991. This represents around 1.2% of all payments in the Community in 1990 and 1.3% in 1991 (out of 26 billion and 31 billion transactions respectively).

2.1.2. The number and value of cross-border transfers of sums below ECU 2,500 have been of little significance to date. So, the banks at first hesitated to invest in standardising and automating cross-border transfers of small amounts. As a result, processing here is still comparatively labour-intensive and is more expensive and slower than payments within a country.

2.2. The Commission therefore thinks it only right to ensure that cross-border payments within the internal market are as quick, reliable and cheap as is the case now for payments within the same Member State. But cross-border payments are subject to different conditions from those applying to domestic payments.

2.2.1. Among these are (still) differences in currency, language and even types of writing, the need to report payments abroad to the central banks and, above all, the different means of payment used. For instance, cheques used for cross-border payments may not be machine-readable (or only partially), unlike those used for domestic payments.

2.2.2. Cross-border transfers are hampered above all by differences between countries in the structure and density of bank branch networks, the processing of data and in regional and national clearing arrangements within and between individual banking groups. According to the statistics of the three European banking associations (mid-1993) there are:

- 2,762 commercial banks with 85,300 branches;
- 1,580 savings banks with 63,800 branches; and
- 10,590 cooperative banks with 55,800 branches.

2.2.3. There is a need for comprehensive technical measures and the corresponding agreements in order to handle cross-border transfers between so many banks of varying size with operations ranging from the local to the inter-regional and with branch networks of varying density. It should particularly be borne in mind that very often the banks of the sender and recipient have no business relations and belong to different banking groups.

2.2.4. The ESC drew attention to these factors in its Opinion of 20 March 1991[46]. It will not be possible without more ado - and certainly not in the short term - for cross-border payments to become exactly like domestic payments, even though such a goal is desirable in itself. But the ESC thinks that considerable improvements in the performance of cross-border payments are both necessary and possible.

2.2.5. On 17 December 1992 the ECSAs (see footnote 1) set up the ECBS[47], a joint body for the standardization of cross-border transfers. The ECBS works with the Commission, the European Monetary Institute, Europay International, Visa International, the Society for Worldwide Interbank Telecommunication and the standards committees of the CEN and ISO.

2.3. The ESC welcomes the Commission's intention to discuss guidelines for customer information regarding cross-border face-to-face payments (see point 1.4.4.) in the first half of 1994 with the parties represented in the PSULG (banks, consumers, commerce and SMEs).

2.4. The ESC recommends that the second study on the performance of cross-border payments announced by the Commission, and referred to in point 1.4.[48], be given a wider remit than the first study of February 1993 referred to in point 1.2. The second study would be more representative and its pronouncements carry greater weight if it were given a broader basis. A broader study should not be blocked because of the additional costs borne by the Commission in the field. The findings of the second study would be more representative than those of the first if the following suggestions by the ESC were taken into account:

2.4.1. The study should cover more banks, and not just 34, in all twelve EU Member States. It should preferably include banks which constantly - and not just occasionally - make cross-border transfers to many EU countries for a large number of customers.

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46 ESC Opinion on the discussion paper on payments in the internal market (OJ No. C 120 of 6 May 1991).

47 ECBS: European Committee for Banking Standards/Comité Européen de Normalisation Bancaire/Europäischer Ausschuß für Bankstandards Secretariat: Place Jamblinne de Meux 34/35, B 1040 Brussels.

48 Invitation to tender 94/C/5/09, OJ No. C5/15 of 7 January 1994; this study should not be confused with that on the cross-border payments services offered by large credit institutions, which was requested by the Commission's consumer policy department from Mr Bruno Dupont.

2.4.2. It should include institutions in other banking categories such as regional, savings, cooperative and private postal banks, in addition to big banks. Instead of simply covering four banks in the larger and two in the smaller countries, the study's sample should be as representative as possible. It could then reflect more accurately the importance and market share of the institutions and individual countries concerned in cross-border transfers. Otherwise, the percentages mentioned have little value.

2.4.3. In connection with the study there should be an examination of the cross-border payment initiatives taken (or announced) by European banking groups, such as IBOS, Europartners or TIPANET as well as B.EPSYS and the ACH (Automated Clearing Houses) alliance, and the experiences of, for instance, the Banco Popular Español in transferring annuities on behalf of the social security institutions of several countries (Switzerland, Italy, France, Germany, Netherlands) for 1.8 million Spanish workers formerly working abroad.

2.4.4. Also worth looking at by the Commission in connection with the study are the possibilities offered by banking groups with closely-knit member networks of mostly small banks with branches in all - or almost all - Member States. These banking groups use their own transfer facilities, network operators, clearing houses and "gateways", such as the private postal banks' "Euro-Giro" or the savings banks' "Eufiserv". Within these networks, and thanks to their common institutions, they can avoid correspondent banks and make direct payments to accounts with members institutions in other countries.

2.4.5. Instead of just considering schematically the fastest possible performance of 1000 transfers of ECU 100 each, the study should also look at how long transfers take when the sender is more interested in cheapness than speed. Finally, as well as ECU 100 transfers, the study should investigate cross-border transfers for sums of ECU 1000-3000 made by both private households and smaller businesses.

2.5. The ESC welcomes the Commission's intention to encourage useful forms of co-operation between banks aimed at improving cross-border payment systems. It asks the Commission to check first under what conditions the competition rules in Article 85 et seq. of the EEC Treaty would be applicable, by analogy with the waivers granted under the Eurocheque agreement.

2.6. Cross-border payment systems can only be based on the principle of agreement between all the institutions involved. In Annex C of its working document of March 1992[49] the Commission itself declared that cross-border payment services could not be provided efficiently without agreements.

2.6.1. Without agreements it is not possible to make large numbers of payments via several institutions in both the sender's and recipient's countries on terms known in advance, because not all the institutions involved have business relations with each other. Such agreements must cover technical specifications and banking standards. Cross-border payment procedures and the calculation of costs and fees must also be the subject of common accord. Only joint agreements make it possible to work out flat-rate fees which are independent of the distance between the countries and locations of the sender and the beneficiary.

2.6.2. Equally, the desired transparency of the conditions which are to be the subject of customer information is only possible on the basis of agreements. And if the various cross-border payment systems are to be mutually accessible - and therefore accessible to the customers of other banking groups - agreements must also be concluded between these systems and with the credit card companies, which operate worldwide.

2.6.3. The Commission has defended the following principles since its Decision of 10 December 1984 on the Eurocheque Agreement (OJ L35 of 7 February 1985, page 43).

2.6.3.1. Agreements between institutions on the fees to be charged to clients are incompatible with Article 85 of the EEC Treaty.

2.6.3.2. Exceptions can be made for interbank agreements on the fees to be charged between institutions under Article 85(3). According to the Commission[50] exceptions are justified if the agreements bring about an improvement for customers and if only maximum rates are laid down for fees and these rates may be undercut by the banks in competition with each other. Under no circumstances may the maximum rates be systematically applied across-the-board and passed on to customers.

2.6.4. Exceptions have already been made under Regulation No. 17 for interbank charges on Eurocheques. Such exceptions under Article 85 seem all the more justifiable in the case of large-scale cross-border payments involving thousands of mainly smaller institutions which are not all linked together in their business relations. An agreement on maximum charges for interinstitutional business would give the network operator a base for calculating how to offset some of his costs within a payments system embracing a multitude of countries, banks, means of payment, gateways and settlement houses. The ESC asks the Commission to consider these arguments with regard to cross-border payments systems which compete with each other in offering services to their customers. The Commission has already considered this matter in Annex C, paragraph 3C, of its working document of March 1992[51].

2.7. Subject to the study being widened as recommended in point 2.4.1., the ESC agrees with the following

49 SEC(92) 621 of 17 March 1992; see too the Report of the European Commission on Competition Policy (COM(94) 161 fin of 5 May 1994) chapter III 119 and 120.

50 See C.D. Ehlermann in the Quarterly Review of European Law 3/1993, page 457 et seq. and "The Vanni d'Archirafi Doctrine" in European Institutions and Finance, No. 1a (March 1994), page 2.

51 SEC(92) 621, of 17 March 1992.

criteria for measuring progress in the performance of cross-border payments.

2.7.1. As regards the requirement that full written customer information in accordance with the guidelines set out in point 1.1. must be provided in at least two-thirds of the branches of the banks surveyed, it should be borne in mind that there are some 200,000 bank branches in the 12 Member States. The constant provision of written customer information in such a big branch network should mean that this information is available to customers on demand. Account should also be taken in this part of the survey of verbal information and advice given to customers by bank staff.

2.7.2. Double charging (i.e. of both sender and beneficiary) is unacceptable and inadmissible. In accordance with the criteria laid down the Commission would only consider progress to have been made in cross-border transfers if double charging occurred in less than 10% of cases. It would be more realistic for the evaluation of the study to relax this criterion to 25% of all cases. Banks interested in discovering the reasons for double charging should be given the means to carry out an investigation so that such cases were no longer repeated. Double charging should be defined as follows: charging both the sender and the beneficiary for the performance of a cross-border payment even though the sender has given instructions that all transfer costs are to be borne by him alone and these instructions have been accepted by the sender's bank.

2.7.3. A cross-border transfer should be considered to have been performed on time if the deadline agreed with the customer is not exceeded. The processing of a payment order no later than one working day after the day on which it is received should be subject to the entry of the amount of the payment itself.

2.8. The ESC supports the call of the European Bureau of Consumer Unions (BEUC) for a ruling on liability in the event of improper execution of mass cross-border payments. The ESC understands the Commission's Recommendation of February 1990 on the setting-up of complaints centres. In its Opinion of 20 March 1991[52] the ESC had already spoken of the success of such centres in Belgium. The complaints centres set up in the Member States could work together informally at European level (see point 3.7.3). Customers could then apply to a complaints centre in their own country, which could contact complaints centres in the beneficiary's country for an explanation.

2.9. The ESC prefers a code of good conduct to a directive. The ECSAs' guidelines referred to in point 1.1. amount largely to such a code. The users of cross-border payment systems represented on the Commission's PSULG (consumers, commerce and SMEs) were consulted on these guidelines. The guidelines could be further developed into a code or charter in which the provider of cross-border payment services would have to assume certain obligations. For instance, the obligations in Article 4 of the draft proposal for a Directive (point 3.3.4) would be better regulated in a code or charter. The idea of a charter is particularly supported by the Commissioner responsible for consumer protection, Christiane SCRIVENER[53]. In her view such a charter would be signed by the ECSAs, consumer associations and the Commission. To this extent it would be a binding charter and a charter that the public has heard of.

2.9.1. The self discipline of a code of good conduct would, in particular, include individual banks having to advise their customers on the advantages and disadvantages of various means of payment (transfer, cheque, card) including the time actually taken by these means and the approximate costs involved. For customers the conditions must be clear and it must be possible to compare the offers of competing banks. Since more and more customers have accounts with several banks, competition will make for greater transparency.

2.9.2. If a Directive is proposed at all it should be limited to setting out a very general framework. A European Directive which imposes detailed binding conditions on banks for cross-border transfers could bring consumers more disadvantages than advantages. It is to be feared that many, above all smaller, banks would then simply refuse orders for cross-border transfers because they would be unable (or unwilling) to comply in advance with the obligations laid down in detail in the Directive.

2.9.2.1. Such orders for transfers could be refused on principle, especially transfers to beneficiaries in areas situated far from financial centres or to accounts with small local banks. This could give rise to significant gaps in a Europe-wide, all-embracing cross-border transfers market.

2.9.2.2. According to the Commission's study of February 1993 some 7,800 of the total of some 10,000 credit institutions in the 12 Member States are active in cross-border transfers, i.e. less than 80%. This figure could fall sharply if cross-border transfers were made subject to detailed legislation. That would be the very opposite of what the Commission, the credit industry and customers want.

2.9.3. The gaps which might arise in a Europe-wide, all-embracing cross-border transfers market if a Directive were introduced could at best be filled by the public postal services. Only the public postal services, as part of the public sector, could, and indeed would have to, accept orders for cross-border payments at any branch, and indeed would have to meet all the obligations relating to these operations which would be regulated in detail in a European Directive. In this connection cash-carrying postmen could make payments to beneficiaries in isolated areas who do not have an account.

2.10. The specific comments which follow in chapter 3 will state the ESC's position on the proposed Directive which the Commission took the precaution of announcing in its Communication of December 1993.

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52 ESC Opinion on the discussion paper on payments in the internal market (OJ No. C 120 of 6 May 1991).

53 See contribution of Christiane SCRIVENER to the colloquium on cross-border payments in Paris on 1 March 1994.

3. Specific Comments

3.1. If the Commission decides to send the Council a proposal for a Directive on the transparency and efficiency of cross-border payment systems, this should only lay down minimum requirements for the whole EU. The ESC is pleased that Article 1(3) leaves it up to the Member States to enact, where appropriate, additional provisions in which the structure of the credit industry and the special features of cross-border transfers can be taken into account. The Commission has justified the initiatives it has taken since 1990 by stating that the large-scale transfer of small amounts should be encouraged. This aim is not expressly mentioned in the draft of the proposal for a Directive. Neither is the scope limited exclusively to cross-border transfers of small amounts on a large scale (see point 3.2.).

3.2. Scope (Article 2)

It should be made clear that the proposed Directive is designed for large-scale cross-border transfers of small amounts, and not for the larger amounts involved in traditional foreign trade, which are now already sent via SWIFT (Society for Worldwide Interbank Financial Telecommunication). The fourth recital stresses the need to make a distinction between cross-border transfers of large sums and transfers of large numbers of small sums. But mention is simply made of a threshold of ECU 10,000, above which cross-border payments have to be reported for statistical purposes in many Member States. Moreover, in Article 7(2) payments over ECU 10,000 are exempted from the refund obligation. If this upper limit is to be used - even if only implicitly - as a definition for large-scale transfers of smaller amounts, it should be made clear that the Directive would apply to transfers by private households and small and medium-sized enterprises (SMEs).

3.2.1. It should also be made clear that the Directive does not apply to cross-border transfers in non-EU countries.

3.2.2. The Directive should apply not only to credit institutions within the meaning of Article 1 of Directive 77/780/EEC (OJ L322 of 17 December 1977) but also to other institutions which perform cross-border payments as part of their professional duties, such as credit card companies. It should include all means of payment such as transfers and cheques and all processes such as standing orders or POS (point of sale) debiting. It therefore seems advisable for Article 2d to mention Eurocheque cards and credit cards, since these plastic cards are increasingly being used across borders for "tele-shopping" and mail orders, especially in frontier areas.

3.2.3. Credit institutions which cannot make cross-border payments (or which do not wish to do so because of the terms of the proposed Directive) should be excluded from its scope, especially from Article 3.

3.3. Transparency (Articles 3 and 4)

3.3.1. The written information which must be given to customers before a cross-border transfer is made largely corresponds to the voluntary obligation which was taken over by the member institutions of the three big European credit industry associations in their guidelines of March 1992 (neither the public postal banks nor the British building societies belong to any of the ECSAs).

3.3.2. An important complement to the written information is the verbal advice normally given by most banks to customers about the most advantageous way for them to make a cross-border transfer. On the basis of such advice customers can decide, for example, to make out a Eurocheque to a beneficiary for small amounts or accept a longer delivery time for non-urgent payments so as to avoid the higher costs of a "premium speed service".

3.3.3. Some information about a cross-border transfer, especially in remote regions, cannot be given to a customer in advance with absolute certainty. Such matters, especially about exact delivery time, cannot therefore be covered by a European Directive.

3.3.3.1. In many cases, when an order is given, the bank can only give the customer an estimated delivery time for payment based on experience. Very often cross-border transfers involve several successive banks which have no business relations with the sender's bank (see point 2.2.1.2.). In "network to network" transfers in particular (i.e. to an account with a branch of a bank from another banking group) the sender's bank possibly has no experience in the rapid forwarding of funds abroad or in how to use foreign clearing systems. So, customers cannot be given a binding figure for the exact time taken before the amount is credited to the beneficiary's account. The second indent should therefore read: "the approximate time".

3.3.3.2. The sender can only be told in advance the value date of the debit from his account, not the date on which the beneficiary's account is credited.

3.3.3.3. It seems obvious that the customer should be notified in advance of the exchange rate for a cross-border transfer. However, some currencies can undergo massive exchange rate fluctuations. This was shown particularly in autumn 1992 and again in 1993. Since 2 August 1993 parities in the EMS exchange rate mechanism can each fluctuate 15% above or below their central rates. It would therefore be a good idea to tell the customer the current exchange rate when the order is given and indicate it on a notice alongside the counters. However, conversion rates cannot be given in printed brochures and other written information for customers because it would soon be out of date. At any event, this would have to be pointed out to customers, who expect written information to include the exact exchange rate.

3.3.3.4. The beneficiary should be told the exchange rate used if conversion is not carried out until the payment reaches his country. It is not necessary to inform the beneficiary about the exchange rate if it was agreed to transfer a given amount in the currency of his country, as is normally the case. In these cases, the beneficiary does not need to know the amount paid by the sender in his currency, especially as the sender may possibly have been granted special terms which are covered by banking secrecy. However, the

beneficiary can rightfully expect to be told the name of the sender and the purpose of the payment.

3.3.4. As regards information for the sender after a cross-border transfer, most banks comply with the industry guidelines of March 1992. This means that senders receive the evidence referred to in Article 4 about the performance costs charged with a listing of fees, commissions and taxes and an exchange rate statement, which according to the February 1993 study happened in over 80% of cases.

3.3.5. In cases where the sender also bears performance costs in the beneficiary's country, these should be communicated to the beneficiary with the proof of payment. The February 1993 study shows that this is clearly not always the case. Banks should therefore take care to ensure that when a cross-border payment is forwarded the sender's wish to pay the costs charged by the beneficiary's bank is also passed on to the various institutions involved.

3.4. Obligations to execute in good time (Article 5)

3.4.1. The ESC supports the wish that a cross-border transfer should be performed as quickly as possible unless the sender agrees otherwise. This seems in any case to be normal banking practice.

3.4.2. There are reservations about the deadline of six working days laid down in Article 5. Some cross-border transfers are not made directly between two correspondent banks in major financial centres, as would ideally be the case. Take, for example the cases where the sender and/or beneficiary are based in areas away from the financial centres and have accounts with branches of small local or regional banks. In these cases several institutions from the same banking group - or even from another group - often have to be involved; not all of them have business relations with each other. This means:

3.4.2.1. Transfers can take much longer if they have to go through several parties (e.g. from the branch of a local bank in the sender's country to another regional or national institution with correspondents in the beneficiary's country and then on again through a national or regional institution to a local institution and its branch).

3.4.2.2. In the beneficiary's country there are often foreign banking groups with which the sender's bank has no business relations. The latter then has no more influence on the execution of payment in the other country or on any omissions which may arise there.

3.4.2.3. A further consequence is that a bank involved in the transaction cannot be obliged to ensure payment no later than the working day following receipt of the order when it itself has not yet been credited with the payment. On the contrary, it must be left up to this bank to decide whether or not to take the risk and pay out the money before it has received cover itself from the foreign bank.

3.4.3. According to the February 1993 study, a cross-border transfer takes 3.2 days on average if one counts the time taken between the debiting of the sender's account and the crediting of the beneficiary's account, and 4.6 days if one counts the time taken between the sender placing his order and the crediting of the beneficiary's account. This result can already be regarded as satisfying even if it is largely made up of the present large number of direct transfers between correspondent banks in the major financial centres. The banks use the "value" definition for calculating the time taken for a transfer, which is important in the case of larger amounts because of the losses or gains of interest involved. The Commission, however, thinks it better to count the time taken from the giving of the order. The ESC supports this method, which is also contained in the UNCITRAL framework provisions.

3.4.4. A binding deadline for cross-border transfers seems inadvisable, for the reasons given in point 3.4.2. Even the Commission's Legal Framework Group doubts that such conditions are necessary (point 19 of the Report of the Legal Framework Group and XV 154/93 of 3 December 1993).

3.4.5. If a binding deadline is introduced, many banks - especially smaller ones - may simply refuse to accept transfer orders when they themselves have no say in the execution of payment by foreign banks in another country.

3.5. Obligation to execute in accordance with the payment order (Article 6)

3.5.1. In cross-border transfers each party has so far normally (in 94% of all cases) paid his own bank charges (the so-called SHARE regulation). But the proposed Directive will aim to make it the general rule for the sender to bear all costs so that the beneficiary is credited with the full value of the transfer without deductions. This so-called OUR regulation (all costs to sender) is becoming increasingly important in smaller transfers. New payment networks such as TIPANET or the ACH (automated clearing houses) alliance are based on, or are due to be based on, the OUR regulation.

3.5.2. The February 1993 study only looked at "OUR regulation" cross-border transfers. It emerged that in 43% of cases the beneficiary also had to pay charges even though the sender had specifically agreed with his credit institution to pay all costs and have the beneficiary credited with the full amount without deductions (see point 2.7.2). In the event of such "double charging" the sender's bank should refund this "unjustified charge" to the sender, in accordance with Article 6(2), and forfeit the fee originally charged to him, even if the beneficiary's bank is the sole party responsible. For the sender, who can only hold his own bank liable, such a rule seems understandable. But for the sender's bank such a wide-ranging liability seems unreasonable in view of the conditions mentioned in points 2.2.2, 2.2.3 and 3.4.2., at least if the beneficiary's bank is insolvent.

3.5.3. For reasons of confidentiality the European credit industry's associations were not allowed to see the data for the February 1993 study. So they still do not know the reasons for the reported cases of double charging.

3.5.4. The Commission should ensure that the second, 1994 study referred to in point 1.4. gives exact details of any cases of double charging. The credit industry could then investigate these cases, which are quite contrary to normal banking practice but which might have been caused by incomplete or even incorrect information from the sender. Article 6(2) should therefore, as a precaution, make an exception in the event of any contributory negligence on the part of the sender.

3.6. Obligation of institutions to refund in case of failed transfers (Article 7)

3.6.1. Article 7(1) lays down that if the transfer is not properly completed by the sum being credited to the beneficiary's account, the sender's bank must refund the full amount of the transfer plus fees to the sender. For the sender's bank this would introduce the concept of no-fault liability. On the other hand, the sender's bank is entitled to claim a refund from the other institutions involved in the payment chain which have not carried out instructions properly. But the refund is by no means so certain as to offset the no-fault liability completely.

3.6.2. Article 7(2) lays down that the refund can be applied for no earlier than 20 working days after the date on which the cross-border transfer should have been made. Even with this time limit it is conceivable that the sender will get his money back, even though the beneficiary has been credited with payment in the meantime and has the sum at his disposal.

3.6.3. It is not clear to what extent the refund obligation applies in the event of force majeure. In Article 7(2)(j) reference is made to the definition of force majeure in Directive 90/314/EEC (OJ No. L 158 of 23 June 1990, page 59). It should be made clear whether the refund obligation still applies if the beneficiary's bank declares a moratorium or if bankruptcy proceedings are initiated before it can credit the transfer to the beneficiary. Such cases would obviously not be regarded as force majeure, at any rate not for amounts of less than ECU 10,000.

3.7. Complaints centres (Article 8)

3.7.1. For customer complaints which are not resolved by the institutions concerned independent complaints centres are to have competence in all matters, in accordance with Article 8(3). Depending on the prevailing principle of subsidiarity within a country the centres may be set up either by the banks themselves or by the central banks or authorities in the Member States.

3.7.2. As the complaints centres cannot be part of the legal system, it seems to be going too far to tell Member States in a European Directive (as in Article 8(5)) that they have to see that the decisions of the complaints centres are published regularly.

3.7.3. Cross-border cooperation between complaints centres may be a good idea. Customers could then apply to a complaints centre in their own country, which could then get in touch with centres in the beneficiary's country. For such cooperation between centres, and for the setting-up of a European ombudsman, binding EU rules would be unnecessary.

OPINION

of the

Economic and Social Committee

on

Removing the legal obstacles to the use of the ECU

Procedure

The Economic and Social Committee decided on 29 June 1993, in accordance with the fourth paragraph of Article 20 of the Rules of Procedure, to draw up an Opinion on

Removing the Legal Obstacles to the Use of the ECU.

The Section for Economic, Financial and Monetary Questions, which was responsible for the preparatory work, adopted its Opinion on 8 February 1994. The Rapporteur was Mr MEYER-HORN.

At its 313th Plenary Session (meeting of 23 February 1994) the Economic and Social Committee adopted unanimously the following Opinion:

1. Preliminary Remark

1.1. On 23 December 1992 the EC Commission submitted to the European Council a White Paper on removing the legal obstacles to the use of the ecu54.

In this White Paper the Commission calls upon the Member States to guarantee the legal status of the ecu as a foreign currency and take measures concerning:

- the use of the ecu in private contracts (e.g. ecu payment clauses);
- court decisions based on legal procedure;
- business management and organisation (e.g. publication of prices and accounts); and
- customs and taxation (e.g. tax payments in ecus).

1.2. The Commission does not advocate a Community regulation; instead, it leaves it up to the individual Member States to take the measures they think fit in accordance with their own national laws, so that no-one is put off from using the ecu because of the laws or administrative procedures in force (§40).

1.3. The Commission points out in the White Paper that:

- the European Council declared that wider use of the ecu should be encouraged (Dublin, 25/26 June 1990); and
- the European Monetary Institute has the task of facilitating use of the ecu and overseeing its development, including the smooth functioning of the ecu clearing system (Maastricht Treaty Art. 109f(2)).

1.3.1. The Commission feels that wider use of the ecu during the transitional phase will facilitate its introduction as an independent single currency in the Community (Maastricht Art. 109l(4)) in the third phase (§77).

1.3.2. The Commission sees the changeover to the single currency as a complex event requiring careful preparation. This includes giving citizens, businesses and administrations the chance of getting some experience of using the ecu unhampered by legal restrictions (§74).

1.4. The Commission has described the type of legal obstacles to the use of the ecu in the White Paper and listed them in a 78-page Annex. The White Paper is based on a survey among banks and firms and on a vast study of several thousand pages which was completed at the end of 1991 (§16).

2. General Comments

2.1. The ecu's status as a foreign currency

2.1.1. Use of the ecu will not be encouraged merely by removing legal obstacles. During the transition to economic and monetary union the ecu will remain a basket currency with many disadvantages and risks. The Commission itself rightly points out that the ecu is not always the best currency for transactions during the transitional phase (§74). A declaration to boost public confidence in the present and future role of the ecu therefore seems necessary (see point 2.3.2).

2.1.1.1. But removing the legal obstacles to the use of the ecu is a step in the right direction. For if, in a few years time, the ecu is to be introduced, one cannot very well shortly beforehand still have legal constraints on the use of its precursor, the ecu basket currency. Article 109l(4) of the Maastricht Treaty states that the ecu is to be introduced "at the starting date of the third stage". However, removing the legal obstacles to the ecu's use should not go so far as to give it the status of a legal means of payment during the transitional phase. This would be irreconcilable with the unrestricted independence which the national central banks are to retain until the start of the third stage. During the transitional phase it is the national central banks alone who will remain competent and responsible for deciding what should be the legal means of payment on the territory of their respective Member States.

2.1.1.2. The key to removing the legal obstacles, as the Commission rightly sees it, is the fact that no country issues ecus as legal tender. (The Belgian and Irish ecu coins are not really legal tender; in practice they are collectors' items)(§18). Some Member States recognise the ecu as a foreign currency in law (Belgium, France, Greece, Italy, Luxembourg, Spain and Portugal) or in practice (Denmark, Ireland and the Netherlands).

In the UK there is no special legal rule concerning the ecu, so it can be used as a foreign currency. In Germany the ecu is regarded simply as a unit of account. But the Bundesbank has said that banks in Germany can operate ecu accounts and grant loans in ecus[55].

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[54] SEC(92) 2472 final

[55] e.g. Notice 1002/90, Bundesanzeiger of 5 January 1990.

2.1.1.3. If the ecu were officially recognised as a foreign currency in all Member States, many of the legal obstacles to its use would disappear (§51). This remark by the Commission is correct. But this on its own may not necessarily mean that use of the ecu would increase.

2.1.2. Not only legal obstacles have to be removed if the ecu is to be used more during the transitional phase. The hesitancy towards the ecu is due above all to the costs and exchange risks involved when converting national currencies into ecus and back again.

2.2. The exchange risks of using the ecu

2.2.1. The economic barriers to using the ecu cannot be removed by order.

2.2.1.1. The risks of using the ecu and other foreign currencies have become clear to the general public with the changes in the exchange rates of the individual currencies against the ecu since August, the turbulence on the foreign exchange markets in autumn 1992 and summer 1993 and the decision of the finance ministers and central bank chairmen on 2 August 1993 to widen the margin of fluctuation of exchange rates in the European Monetary System to 15% either side of mid-rate.

2.2.1.2. The exchange risks of using the ecu or any other EU currency can only be expected to decrease if a greater convergence of key national economic data is achieved. In conditions of recession and mass unemployment greater convergence will only be achieved in the foreseeable future if there is a corresponding political will. In its Opinion on policy during the transition to economic and monetary union[56] the ESC has pointed this out and identified three preconditions for this to occur:

2.2.1.2.1. Better co-ordination of national economic policies at EC level.

2.2.1.2.2. Intensive multilateral supervision of them at EC level; and

2.2.1.2.3. Mutual synchronisation of convergence and recovery programmes.

2.2.2. As long as the preconditions mentioned in point 2.2.1.2 are lacking, one cannot count on private households using the ecu. Under these circumstances it is only right that the Commission should not propose any measures to forcibly promote use of the ecu. That could only lead to deception and disappointment which would be bad for the ecu's image. And such disappointments would be prejudicial to the introduction of a single currency with the name "ecu" in the third phase of economic and monetary union.

2.2.3. So, initially the removal of legal obstacles to the use of the ecu would, above all, benefit companies trading internationally. According to the White Paper (§7) the ecu so far accounts for only 1 or 2% of the Member States' external trade. But by mid-1993 the volume of ecu credits was running at some ECU 200bn while clearing house payments in ecus amounted to some ECU 50bn per day.

2.2.4. The ecu is increasingly used in the clearing systems of international organisations such as EUROCONTROL for flight safety, AMADEUS for flight and hotel reservations and the UIC for settling payments between railway companies, which for this purpose list their prices per kilometre each year in ecus. According to the Commission's data bank in Directorate-General II-D/2 turnover amounts to ECU 2,150m for EUROCONTROL and ECU 7,500m for the UIC[57]. In 1993 over 35% of the expenditure from the Community budget of around ECU 70bn was settled in ecus (in 1987: less than 6%).

2.3. Informing the public and confidence in the ecu

2.3.1. In addition to the White Paper on the legal obstacles to the use of the ecu, the Committee recommends that the European citizen be informed in a suitable and understandable way about what will be going on during the phase of transition to economic and monetary union, which will begin on 1 January 1994[58]. The object of the folders, brochures, etc. should be to provide an answer to the questions which citizens ask, and in particular those concerning:

2.3.1.1. The impact of economic and monetary union on private households.

2.3.1.2. The advantages and risks of using the ecu during the transitional period.

2.3.1.3. The practical results of replacing national currencies by a single European currency, the ecu, in the third phase, especially as regards the circulation of notes and coins, pricing, accounting, issuing and redemption of securities and bookkeeping.

2.3.2. If the Commission does inform the public in cooperation with the appropriate authorities in the Member States, as referred to in point 2.3.1, the European Monetary Institute should be consulted.

2.3.3. It seems necessary to inform the European Monetary Institute of all measures taken by the Member States to remove legal obstacles to the use of the ecu. This particularly applies to the prudential obligations applying to credit institutions' ecu risks (see point 3.1.2).

2.3.4. Informing the public means covering the various possibilities of using the ecu basket currency during the transitional period with all the risks involved (see points 2.2.2 and 3.1.7.3) but also the many advantages.

[56] See Analysis of the policies to be followed in the transition to economic and monetary union, OJ No. C 34/25 of 2 February 1994.

[57] See European Economy, Supplement A No. 4/93.

[58] See OJ No. C 34/25 of 2 February 1994, point 1.6.1.

2.3.4.1. Among the advantages: under Article 109l(4) the ecu basket would be converted into the independent - and ultimately only - EU common currency at a rate of 1:1, while the exchange rates of the individual national currencies in ecus would remain uncertain until the end of the transitional period. So, even though it is only a basket currency at present, the ecu would legally change into the ecu of the third stage of monetary union. If, for example, money was invested during the transitional period in longer-term bonds denominated in ecus[59] interest and redemption payments falling due during the third stage would be made in the future common European currency at a rate of 1:1 with the present ecu.

2.3.4.2. Another advantage, which is not generally known, is that under Article 109g of the Maastricht Treaty the composition of the ecu basket would be "frozen" in the second stage. So, the amounts of the individual national currencies making up the ecu would no longer change. But, depending on exchange rate developments, the weighting of the individual currencies (and thus their respective percentage of the currency basket) can change. In other words: instead of the two risks which have existed to date - namely changes in the make-up of the basket and changes in the exchange rate - there is now only the exchange risk. For the markets it will be easier to obtain or liquidate ecu assets when these percentages become fixed[60].

2.3.4.3. A further use for the ecu currency basket during the transitional period arises from the obligation incumbent upon the Member States to pay in ecus into the Communities' budget for the Structural Funds and withdraw sums in ecus from Community funds for payment to beneficiaries. Because of the increased number of transfer payments in ecus the need for ecus and the possibilities of settlement will increase too. This may perhaps also lead to a greater interest in the Member States in receiving tax payments in ecus (see points 3.3.2 and 3.3.3).

3. Comments on the individual proposals

3.1. The ecu as a means of payment, a mortgage currency and its legal status.

3.1.1. We support the Commission's recommendation that all Member States should grant the ecu legal status as a foreign currency and expressly provide for the following possibilities (§49):

3.1.1.1. Use of the ecu in contracts (§50).

3.1.1.2. Issuing of bills denominated in ecus and payment of ecu paper issued by non-EC countries (§27, 52), quotation of share prices in ecus (§33);

3.1.1.3. Operation of ecu sight and deposit accounts with interest, allowing payments in ecus (§53).

3.1.2. It also seems advisable to adjust the monitoring rules so that credit institutions' and insurance risks in ecus are not placed at a disadvantage compared with risks in other foreign currencies (§54).

3.1.3. Finally, the rules of the individual Member States on the use of the ecu should no longer draw distinctions in business relations between residents and between residents and non-residents (§56).

3.1.4. The Belgian Law of 12 July 1991 (Moniteur Belge of 9 August 1991), the French Law of 16 July 1992 (Journal Officiel de la République Française of 18 July 1992) and the Luxembourg Law of 29 July 1993 provide examples for removing legal obstacles to the use of the ecu as referred to in point 3.1.1.

3.1.4.1. The Belgian Law, which amends Article 3 of the Law of 30 December 1885, stipulates that public and official documents may be expressed not only in Belgian francs but also in ecus or in the currency of any one of the 24 Member States of the OECD (Organisation for Economic Co-operation and Development).

3.1.4.2. The French Law concerns the promotion of and tax concessions for equity savings plans (PEA). But in its Article 14 it allows liabilities to be expressed in ecus. Before this condition is exercised, contracts between residents can be annulled if they stipulate a payment in foreign currency where there is no cross-border business involved. The Law has not changed the French franc's status as the sole means of legal tender. Moreover, both parties to the contract must first agree to the use of the ecu. Subject to this condition, use of the ecu is to be permitted by the authorities in, for example, public calls for tender, taxes and the issuing of government bonds (Article 37§44 of the French Finance Bill).

3.1.5. The Belgian and French laws referred to in point 3.1.4 are steps in the right direction. But they still do not resolve the problem that in certain cases, such as auctions and property deals, some Member States' laws insist on cash payment in banknotes and do not allow funds on deposit to be made available through payment by cheque, bank transfer etc. As no Member State has ecus in circulation (see point 2.1.1), giving the ecu the same legal status as a foreign currency only allows ecus to be actually used if payment by funds transfer is allowed, as funds in ecu accounts can then be made available.

3.1.5.1. Even the European Convention of 11 December 1967 on foreign currency liabilities (Article 5 of the Annex thereto) draws no distinction between cash and deposit money. But legislation and case-law in many countries still does not allow deposit money to be treated in the same way as cash unless the contracting parties have expressly agreed to do so. Under these circumstances ecu payments may not be legally acceptable in certain cases for paying off obligations.

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[59] By the end of 1992 the European Investment Bank alone had issued ecu bonds for a total value of ECU 13.4bn.

[60] See Appendix showing the changes in the composition of the ECU currency basket
(Data from Commission Directorate-General II D 2).

3.1.5.2. The removal of the legal obstacles to the use of the ecu would therefore be a good reason for legislators to make payment by funds transfer generally equivalent to cash payments. Even today, in some Member States, cash payment can in fact be enforced if a creditor so wishes or if contracting parties cannot agree. But this seems to be on the way out because of the decline in the use of cash and the measures to combat money laundering.

3.1.6. In court decisions, steps should be taken to ensure that payment obligations can be established and enforced in ecus if contracting parties have agreed to use of the ecu. The pledging of assets in ecu accounts should also expressly be allowed to discharge a debt. The debtor should have to bear the costs of any conversion into local currency. Any conversion should be at the exchange rate prevailing on the day of the court's judgement (as provided for in, for instance, Articles 1018 and 1650 of the Belgian Legal Code).

3.1.7. A further area for using ecus involves the legal possibility of registering mortgages in ecus and allowing mortgage loans in ecus. The Belgian Law of 12 July 1991 already makes provision for this (in Article 3) and for converting ecu mortgages into local currency. The changes in the ecu's exchange rate with national currencies since autumn 1992 have shown that ecu mortgages involve considerable risks for mortgage-holders if the national currency is devalued against the ecu, and these risks should be specially brought to the mortgage-holders' attention.

3.1.7.1. In recent years mortgage loans and other forms of credit in ecus have been offered at much lower interest rates than those in local currency. But the fall in value of some currencies against the ecu since autumn 1992 means that debtors now have to pay more than they expected in local currency for their repayments. The exchange rate loss can be much greater than the gain from lower interest rates - at any rate when the debtor has no income in ecus and has to convert local currency to make repayments.

3.1.7.2. Another often overlooked disadvantage is when a primary mortgage is registered in ecus and the local currency falls in value against the ecu. The value of the mortgage may then become so close to the market value of the property that it is impossible to take out any further mortgage.

3.1.7.3. The risk of ecu mortgages and loans described in points 3.1.7.1 and 3.1.7.2 are an example of the disappointments which private households using ecus may encounter during the transitional period. It is yet another reason to support the Commission's decision not to propose any measures to forcibly promote use of the ecu in the private sector before the third stage (see point 2.2.2).

3.2. Company capital, invoices and accounts in ecus

3.2.1. In line with the White Paper, all Member States should allow their companies the possibility of:

3.2.1.1. Constituting, increasing and decreasing their capital in ecus (§19, 32, 63).

3.2.1.2. Setting and displaying their prices in ecus and invoicing directly in ecus if the contracting parties so agree (§29, 64).

3.2.1.3. Keeping all their books in ecus and publishing the annual accounts and all other accounts in ecus (§34, 63).

3.2.2. The Member States could initially limit themselves to granting the possibilities referred to in point 3.2.1 to companies which trade across borders (§66). Once invoked, the option mentioned in point 3.2.1.1 should always be linked to that in 3.2.1.3, and not just be used for one or two financial years.

3.2.3. Many firms, especially in the retailing, mail order, tourism, hotel and catering sectors, already display their prices in ecus, as described in point 3.2.1.2. Ecu pricing makes it easier to compare prices, particularly in border areas, holiday resorts and in international hotel chains. But to avoid disappointments care should be taken to see that:

3.2.3.1. Ecu prices constantly reflect exchange rate trends.

3.2.3.2. Ecu prices are not routinely rounded upwards; and

3.2.3.3. The rate used for converting prices into ecus is clearly visible in every case.

3.2.4. Firms which submit their company reports and accounts in ecus, as well as in other currencies, should have to show clearly the rate used when converting figures from local currency.

3.3. Customs and taxation in ecus

3.3.1. The customs duties levied at the external frontiers of the EC go straight into the Community's budget, which is drawn up in ecus. It seems sensible to change the EC Customs Code so that the following are possible (§71):

3.3.1.1. The expression of goods' value for customs purposes in ecus.

3.3.1.2. An ecu box on customs forms; and

3.3.1.3. The payment of customs duties in ecus.

3.3.2. It is to be expected that many multinationals will keep all their accounts in ecus, as suggested in point 3.2.1.3. It would therefore be logical for them to also use the ecu for working out and paying their taxes. Otherwise the "taxes payable" column would be the only entry in the accounts still expressed in local currency. As tax payment is a direct relationship between companies and the state it would not be necessary for the ecu to be generally recognised as a legal means of payment with compulsory acceptance.

3.3.3. In France and the Netherlands it is already possible to pay taxes in ecus. Such a facility could also be made available to private households who have income in ecus. But paying taxes in ecus would primarily be considered by firms whose income in ecus exceeded their ecu costs. This would especially apply when the exchange rate against the

local currency worsened during the business year and a surplus in ecus would otherwise become an exchange loss in the accounts.

3.3.4. Tax payments in ecus could also become interesting for national authorities when they needed ecus to pay their contributions to the Community budget (see point 2.3.4.3).

3.4. The ecu in EC law

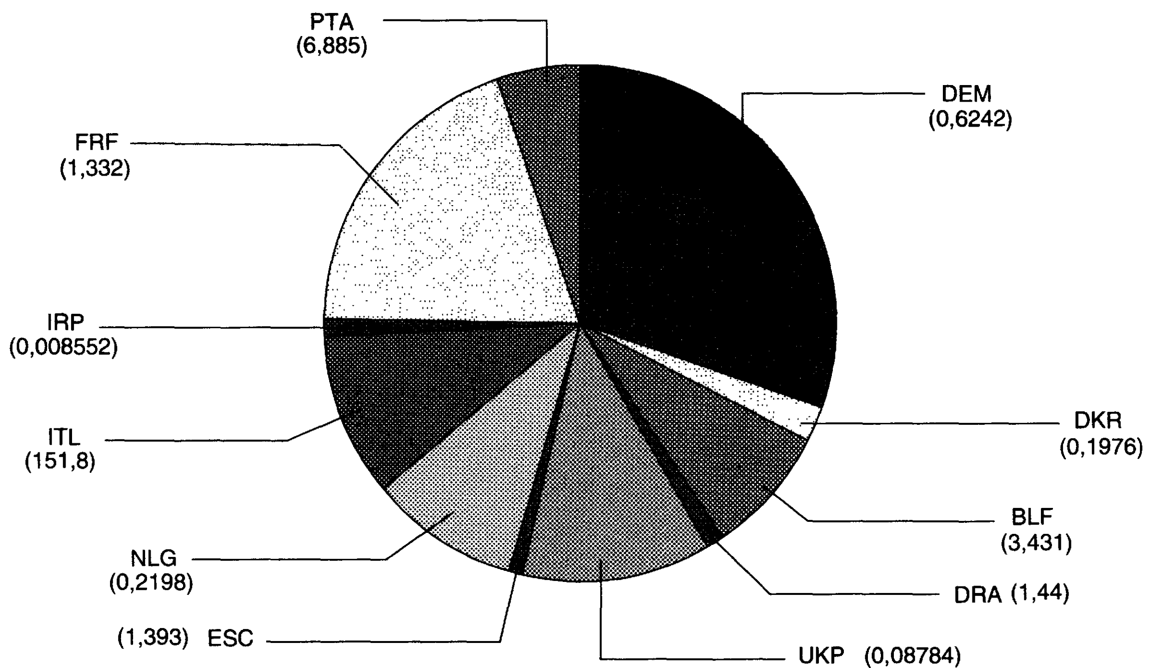
3.4.1. It seems a good idea to refer to the ecu systematically and expressly in EC law.

3.4.2. This particularly applies to the proposals currently being prepared or discussed for regulations, directives and decisions in the fields of insurance, banking, securities trading and company law, and especially those relating to the European company, the European co-operative society, the European mutual society and the European economic interest grouping (§76).

3.4.3. Provision should also be made for using the ecu in public procurement where EC rules on this apply.

THE ECU

COMPOSITION OF 1 ECU, NATIONAL CURRENCY AMONTS



THE CHANGING ECU

- Up to November 1, 1993, a basket currency whose composition was revised every 5 years
- Currently: a frozen basket currency with fixed amounts of component currencies
- From the start of Stage Two: overseen by the EMI, which will also facilitate its use
- From the beginning of Stage Three: a currency in its own right, managed by the ECB
- During Stage Three: rapid introduction of the ecu as the single currency of the European Union, issue of notes and coins.

EVOLUTION OF THE MONETARY AMOUNTS (COMPOSITION) [61] AND WEIGHTS OF THE CURRENCIES COMPOSING THE ECU BASKET

	Start of E.M.S. 17.09.1984		First Revision 13.03.1979		Second Revision 21.09.1989		Present Situation 28.10.1993	
	Monetary Amounts	Weights (in %)	Monetary Amounts	Weights (in %)	Monetary Amounts[62]	Weights (in %)	Monetary Amounts[63]	Weights (in %)
DM	0.828	32.98	0.719	32.08	0.6242	30.32	0.6242	32.63
FF	1.15	19.84	1.31	19.06	1.332	19.29	1.332	19.89
HFL	0.285	10.51	0.256	10.13	0.2198	9.48	0.2198	10.23
BLF	3.8	9.63	3.85	8.57	3.431	8.08	3.431	8.28
DKR	0.217	3.06	0.219	2.69	0.1976	2.52	0.1976	2.56
IRL	0.00759	1.15	0.00871	1.20	0.008552	1.11	0.008552	1.06
Sub Total 1		77.17		73.73		70.80		74.66
LIT	109	9.49	140	9.98	151.8	10.23	151.8	8.16
UKL	0.0885	13.34	0.0878	14.98	0.08784	12.06	0.08784	11.45
DRA	—	—	1.15	1.31	1.44	0.95	1.44	0.53
PTA	—	—	—	—	6.885	5.15	6.885	4.50
ESC	—	—	—	—	1.393	0.81	1.393	0.71
Sub Total 2		22.83		26.27		29.20		25.34
TOTAL (1 + 2)		100.00		100.00		100.00		100.00

61 The monetary amounts (composition) of the ECU are independent of the European Monetary System (EMS). Whether a currency participates or not in the Exchange Rate Mechanism of the EMS has no influence on the composition of the ECU basket

62 Article 109 G has frozen this composition, which means that these monetary amounts will not change up to the beginning of Stage III, when exchange rates will be irrevocably fixed and the ECU will become a currency in its own right.

63 The monetary amounts are those defined on 21.09.1989, frozen up to Stage III. The weights are in % and will change every time the exchange rate of one currency changes. Appreciating currencies will see their weight increase; depreciating currencies will see their weight decrease. Consequently, the frozen ECU will strengthen along with the harder component currencies.

OPINION
of the
Economic and Social Committee
on
Minimum Reserves in the Context of the Internal Market

Procedure

On 23 November 1992 the Economic and Social Committee, acting under the fourth paragraph of Article 20 of its Rules of Procedure, decided to draw up an Opinion on

Minimum Reserves in the Context of the Internal Market.

The Section for Economic, Financial and Monetary Questions, which was responsible for preparing the Committee's work on the subject, adopted its Opinion on 9 March 1993. The Rapporteur was Mr MEYER-HORN.

At its 304th Plenary Session (meeting of 24 March 1993), the Economic and Social Committee adopted the following Opinion unanimously:

Introduction

1. Even in the 1960s the form, use and effectiveness of monetary policy instruments was being discussed in the European Community. In August 1962 the Monetary Committee published a study on "The Instruments of Monetary Policy in the Countries of the European Economic Community". In it the minimum reserves policy introduced in the post-war years in most EC Member States was compared with the open-market policy and the refinancing policy of the central banks. The study states that: "The minimum reserves system enables the monetary authorities to act directly on bank liquidity, and thus on their ability to provide credit. The policy of minimum reserves is thus a useful addition to discount and open-market policies, which tend merely to modify the composition of the aggregate liquidity of the banks" (Chapter 5, point 38).

1.1. Thirty years on in an enlarged Community the role of minimum reserves policy is less clear-cut. There is a marked alignment between the Member States in the use of monetary policy instruments, although the central banks continue to use their monetary policy instruments in different ways in accordance with their own traditions, due to differences in the structure of their banking systems and the particular preferences of central bank directors.

1.2. Besides the requirement to keep a minimum balance with the central bank, there were other, similar obligations which banks had to respect, namely minimum portfolios of government securities. The purpose was to prevent, in the post-war years, a mobilization of the high volume of government bonds in the banks' portfolios. Until very recently in some countries - namely Spain, Portugal, Italy and Greece - the mandatory investments of the banks in government securities helped to finance the public budget deficit through the central bank.

1.3. Since the beginning of the 1980s the so-called open-market policy - i.e. the purchase and sale of securities and certificates of deposit by the central banks - has played an ever greater role. The open-market transactions of the central banks have had far more impact on bank liquidity and the money supply than minimum reserves policy.

1.4. Compared with open-market policy, central bank refinancing of banks by the rediscounting of bills and through loans against securities (Lombard loans) has also lost ground; clearly the complicated and costly credit rating entailed has played a part in this. On the other hand, central bank rediscounting of bills and loans against securities play an important role for the smaller banks and hence for the borrowing of their small and medium-sized business customers.

1.5. The obligation of banks to maintain minimum reserves at the central bank is still used as a monetary policy instrument in most Member States. These minimum reserves are calculated in different ways and changed with varying degrees of frequency. The question is whether this is compatible with the Single Market completed on 1 January 1993 and the Economic and Monetary Union provided for in the Maastricht Treaty, under which a European Monetary Institute is to be established from January 1994 and a European System of Central Banks with a common monetary policy for the Community from 1997 or 1999.

1.6. The role alignment and future of minimum reserves policy is important for the national central banks, which are to form part of a European System of Central Banks. In a monetary union with a common EC monetary policy, minimum reserves policy will be set by the Governing Council of the European Central Bank, ruling out national differences. Even before the third stage of monetary union, the substantial differences in national bank methods of controlling bank liquidity - and hence the money supply - will prove difficult to reconcile with increasingly close-knit money and capital markets. As long as the national central banks remain responsible for their own monetary policy in the internal market, national differences in the application of minimum reserve requirements and in open-market policy will affect monetary policy in other countries and result in dependency, with the inevitable consequences for business and consumers.

1.6.1. Consequently, since 1992 a working party of the EC Committee of Central Bank Presidents has been preparing the ground for ESCB monetary policy, in particular the development of objective monetary policy indicators and compatible money supply targets. Also being discussed are comparable money supply definitions, the alignment of monetary policy instruments and the role of minimum reserves.

1.6.2. Under Article 109f of the Treaty on European Union signed in Maastricht on 7 February 1992, the European Monetary Institute (EMI) to be established in January 1994 will have the task of preparing the instruments and procedures necessary for carrying out a single monetary policy in the third stage of monetary union.

1.7. The alignment of minimum reserve requirements is important to banks even before monetary union, i.e. in the Single Market (as of January 1993) and in the European Financial Area. There is increased competition between the banks themselves and with the so-called non-banks and near-banks.

1.7.1. Differing national minimum reserve requirements are a cost factor which influences inter-bank competition. Certain deposits (on which they must pay interest to their customers) are not available to the banks concerned. This means a loss of revenue and a constraint on trading policy. To this extent those banks which are subject to minimum reserve requirements are at a disadvantage compared with their competitors in other countries who have no - or less onerous - obligations.

1.7.2. Such substantial obligations mean that non-banks, such as large corporations, prefer to invest their liquid assets on the euromarket where they avoid any of the minimum reserve requirements. In this way deposits are taken away from those banks which are subject to high minimum reserves in their own country. With free movement of capital there is nothing inherently wrong with the increasing investment in the euromarket, but it can impede the monetary policy of the central banks, which explains the US initiative in the 1980s for an internationally agreed minimum reserve requirement (see point 2.6.). Furthermore, high minimum reserves in the Member States affect competition between EC banks and banks in non-EC countries. Resorting to the euromarket has an adverse effect on central bank monetary policy.

1.8. The circumstances described in points 1.5 to 1.7 have spurred the Economic and Social Committee to put forward some observations on minimum reserves policy in the European Community and to draw some conclusions. This Opinion confines itself essentially to the competitive situation of banks on the internal market. It does not go into the interplay between minimum reserves policy and other monetary policy instruments, or the "mix" of monetary and financial policy at macroeconomic level. Rather, the Opinion is intended as a contribution to the current discussions of the central bank presidents on minimum reserves policy, especially those of the working party referred to in point 1.6.1. The Committee is, however, aware of the links between minimum reserve policy and the use of other monetary policy instruments. These links are illustrated by the measures taken by the Bundesbank in February and March 1993 simultaneously in several areas - reduction in minimum reserves, offer of additional money market paper, securities-pensions transactions at lower interest rates and reduction of central bank discount and Lombard rates. The monetary policy of a central bank which relies entirely on open-market transactions can even take the form of higher interest rates than would result if minimum reserves were high at the same time. As far as current interest rate policy in the Community is concerned, the Committee would refer to its Opinion on the annual economic report (CES 213/93, point 3.7.).

2. Different ways of applying minimum reserves policy

2.1. The introduction of compulsory minimum reserves was originally justified in some countries on prudential grounds. According to this argument, the obligation to hold minimum reserves at the central bank ensured that banks maintained a certain level of liquidity with which they could cover the withdrawal of deposits by customers. This argument no longer seems valid.

2.1.1. Surveillance of bank solvency is primarily the responsibility of the supervisory authorities. Thus, for instance, it has been admitted that the minimum reserves introduced by the Banca d'Italia in 1926 on prudential grounds have since 1975 been used solely as an instrument of monetary policy.

2.1.2. In the European Community credit institutions must respect certain liquidity and solvency ratios irrespective of central bank monetary policy. As a result of the alignment of the provisions on bank supervision, credit institutions must adhere to the same ratios in all the Member States - based on the recommendations of the Basel Committee of Central Bank Presidents (Cooke Committee) - and in non-EC countries. In addition, deposit guarantee schemes are to be obligatory in all Member States[64].

2.2. In four of the twelve EC Member States monetary policy is not used as an argument for minimum reserves.

- Luxembourg and Denmark have no minimum reserve requirements at all;
- in Belgium the central bank is legally entitled to, but does not, pursue a minimum reserves policy;
- in Great Britain the - few - minimum reserve requirements are not used for monetary policy, but merely as a source of revenue for the Bank of England.

2.2.1. In the eight Member States where minimum reserves are justified on grounds of monetary policy, the trend over recent years has been to reduce the minimum reserves ratios. For instance, the minimum reserves ratios were reduced:

- in France between October 1989 and May 1992 from 5.5 to 1% for sight deposits, from 3 to 1% for savings deposits and from 3 to 0% for time deposits;
- in Spain between February 1990 and December 1992 from 5 to 3% (though minimum reserve-like compulsory investments remain (see point 2.4.));
- in Germany in February 1993 from 4.95 to 2% for time deposits and from 4.15 to 2% for savings deposits;
- in Italy in February 1993 the highest rate from 22.5 to 17.5%.

2.2.2. Overall the importance of minimum reserves has diminished markedly in the Community compared with the money supply and banks' total assets. But as the Single Market comes into operation at the beginning of 1993 there are still considerable differences in minimum reserves policy within the Community which affect competition between the banks of the individual Member States (see appended table).

64 Cf. ESC Opinion of 22.10.1992, OJ No. C 332 of 16.12.1992

2.3. The differences in minimum reserves policy also involve methods of assessment, varying minimum reserves ratios according to type of deposit and the frequency with which the minimum reserves ratios are changed.

2.3.1. For sight deposits, time deposits and savings deposits there are in some cases different minimum reserves ratios, in some cases the same minimum reserves ratio for all categories of deposit:

- in Germany, for instance, the minimum reserve requirements are graduated for sight deposits (according to the total volume of deposits, from 6.6% for sight deposits up to DM 10 million, up to 12.1% for sight deposits over DM 100 million) and, up to February 1993, 4.95% for time deposits and 4.15% for savings deposits (since then a uniform 2% for time and savings deposits)[65];

- in Spain, on the other hand, the minimum reserve ratio is a uniform 3% for all deposits (in addition to the afore-mentioned minimum reserve-like compulsory investments, see point 2.4.).

2.3.2. A graduation of minimum reserves ratios according to type of deposit can be justified on the grounds that the accessibility of the deposits varies. Many central banks, however, have been prompted by other reasons to vary the minimum reserves ratios according to type of deposit:

- the Banque de France, for instance, changed the minimum reserves ratios for time deposits in 1989 and 1990 as a reaction to the unwanted switching from investments in securities to money market paper and to the flight of assets to off-shore financial centres and in May 1992 changed them as a reaction to the interest-rate policy of the Deutsche Bundesbank;

- to counter an unwanted (from the point of view of monetary policy) increase in the assets of non-residents, the Law on the Deutsche Bundesbank, for instance, expressly provides for the possibility of 100% minimum reserves for the assets of non-residents. The Deutsche Bundesbank last availed itself of this facility in 1978 to stem the inflow of foreign exchange at that time;

- in 1987 and 1989 the Banca d'Italia imposed minimum reserve requirements on the at that time unwanted holding of assets in foreign currencies.

2.3.3. Under the terms of the Single Market, the reasons cited in point 2.3.2 for a differentiation of minimum reserve requirements seem dubious. In the internal open-frontier market the movement of money and capital and switches in investments because of interest rate differentials will tend to increase, making it more difficult for individual central banks to pursue a separate minimum reserves policy.

2.3.4. Some central banks change minimum reserve ratios very often, some only seldom. In the Netherlands, for instance, the minimum reserve ratios were changed more than twenty times in 1990, with the result that the minimum reserves of the banks fluctuated by 12,000 million guilders. In Germany, on the other hand, minimum reserve ratios have been changed only three times between 1980 and 1993, in Italy not at all between 1984 and February 1993. The frequent alteration of ratios in the Netherlands is put down to the fact that the central bank is hardly able to pursue an open-market policy on account of the low volume of suitable NLG-paper.

2.3.5. The reference period for minimum reserves also varies from one country to another. Minimum reserve requirements are fulfilled primarily on the basis of the average deposit at the central bank over a reference period. Thus a shortfall in the minimum reserves requirement at the beginning of the reference period can be offset by an excess at the end of the period (or vice versa). Shortfalls/excesses can also sometimes be carried over to the next reference period. The reference period is usually one month, but can be shorter (10 days) or be as long as six months. The sometimes complex calculation of and adherence to the minimum reserves requirement can hamper the commercial policy of banks in the countries concerned.

2.4. In some Member States the central bank obliges banks to invest in securities and certificates of deposit; this is similar to a minimum reserve requirement. These compulsory investments play a particularly important role in Spain. In 1990 the Spanish minimum reserves requirement - then 17% - was split into a cash holding of 5% to begin with and an obligatory investment in central bank certificates of deposit and in Treasury bills (investment ratio). As at September 1992, for instance, the deposits of the Spanish banks (18,826 billion* pesetas) were subject to a total minimum reserve requirement of 18.1%, i.e. 3,408 billion pesetas. Of this, 854,000 million pesetas was in non-interest-bearing deposits with the Banco d'España, 1,737 billion pesetas was invested in central bank certificates of deposit (with 6% interest), and 817,000 million pesetas in other obligatory investments, mainly Treasury bills. These compulsory investments mean that the Spanish banks are virtually obliged to help finance the Spanish budget deficit via the central bank. Bearing in mind that it was agreed in Article 104(1) of the Treaty on European Union that budget deficits should no longer be financed by the central banks (see point 3.5), this form of minimum reserves policy would appear outmoded and no longer permissible from January 1994 (Article 109e (3)).

2.5. As a rule the banks' minimum reserves with the central bank do not receive interest. Accordingly, banks in the countries concerned suffer a loss of income. To this extent minimum reserves constitute a kind of levy on the banks which varies in line with the market interest rates which they would otherwise have received had they been able to place the tied funds on the money market.

2.5.1. In some countries minimum reserves with the central bank receive interest, namely in the Netherlands, Greece and Italy. In Greece and Italy, however, the interest

[65] In Austria, Japan and the USA, too, there are minimum reserve ratios which are graduated according to the total volume of deposits and which favour smaller banks.

* = 1,000,000,000.

is at far below market rates. In the case of Greece, the low interest applies to only half the compulsory minimum reserves, i.e. to 4.5% of deposits. The 6% interest on the compulsory deposits of the Spanish banks in central bank certificates of deposit is only about half the market rate. Hence even in these few cases where minimum reserves bear moderate interest, the banks suffer a loss of revenue.

2.5.2. The Dutch central bank pays interest on "normal" minimum reserves (money market reserve requirements - GKR), but slightly below market rates. In addition, from time to time "fictitious" minimum reserves (monetary reserve requirements - MKR) have been imposed on an exceptional expansion of business by the banks. The minimum reserves were "fictitious" insofar as they did not have to be kept in the form of a balance at the central bank, but obliged the banks to pay the market interest rates on these amounts to the central bank.

2.5.3. The loss of income suffered by the banks from non- or low-interest-bearing minimum reserves puts them at a disadvantage in this respect vis-à-vis non-banks and near-banks. Large corporations, especially multinationals, can practice profit-oriented cash management and invest their liquid funds in "free ports" (where banks are not subject to minimum reserve requirements) and on the Euro-money market (free from direct bank supervision and the guiding influence of central bank monetary policy).

2.5.4. Banks subject to minimum reserve requirements suffer a loss of income which tends to make borrowing from them more expensive and the interest paid on deposits with them lower. To this extent depositors, small savers especially, and borrowers in countries with relatively high minimum reserves are at a disadvantage.

2.6. Varying minimum reserves mean not only a cost disadvantage for those banks, the bulk of whose business is subject to high minimum reserve requirements. The upshot is a "delocation", a switch of assets to the Euro-money market with a risk which is difficult to calculate: namely that in the event of a liquidity squeeze the participating Euro-banks will have recourse to refinancing by "their" central bank. It should be noted that in the face of the stormy developments on the Euro-money markets there was a US initiative at the beginning of the 1980s for an internationally agreed minimum reserves requirement, but this was not followed up.

3. Assessment of minimum reserve and open-market policy

3.1. In the interests of a monetary policy which does not affect competition, under normal circumstances any remaining minimum reserves should be reduced to a uniformly low level, such as results from the "working balances", i.e. the balances which the banks would in any case keep with their central bank. At the same time the bases of assessment for minimum reserves must be aligned (see point 2.3.). Bearing in mind also the competition from the financial centres of major third countries such as the USA, Japan and Canada, Community banks should not be encumbered with relatively higher minimum reserves.

There are, however, various reasons for not completely abolishing the instrument of minimum reserves:

- the option enshrined in Article 19(1) of the Maastricht Protocol on the Statute of the European System of Central Banks and of the European Central Bank, namely for the ECB to require the holding of minimum reserves;
- the continuing differences in open-market policy in individual Member States and the links between the various monetary policy instruments as regards their impact on the money supply and interest rates;
- the particular circumstances of individual Member States' monetary policy, e.g. the case of the DM as an "anchor currency" which is subject to special pressures;
- the additional central bank duties in many countries in connection with refinancing and the settlement of payment transactions; these additional duties may be seen as to some extent a quid pro quo for the minimum reserve requirements.

3.2. Minimum reserves policy has been called upon much less in recent years in the Community. In particular, minimum reserves policy has no longer been used to influence bank liquidity in specific instances, i.e. rapidly and frequently, by changes in the minimum reserves ratio.

3.2.1. Hitherto relatively greater importance has been attached to minimum reserves policy in Germany[66]. The Deutsche Bundesbank sees minimum reserves - even where the ratios do not change over many years - as a buffer and a continuous brake against money creation by the banks. It is the stated objective of the minimum reserve requirements of both the Bundesbank and the Nederlandsche Bank to make the banks dependent on the central bank in terms of volume and predictability, i.e. on a virtually constant demand for central bank money. In Germany's case these arguments certainly cannot be brushed aside in view of the relative importance of the DM money supply.

3.2.2. It should be noted, however, that in February 1993 the Deutsche Bundesbank reduced its relatively high minimum reserve requirement by about DM 32,000 million from, lastly, DM 80,000 million. This brought the average burden on German banks down from about 6 to 3.5% of deposits. This reduction benefited above all the savings banks and credit cooperatives which accounted for about 69% of the 32,000 reduction. The express reason given by the Deutsche Bundesbank for this reduction was that it wished to strengthen the international competitiveness of the German banks. Instead of continuing unchanged with high, non-interest-bearing minimum reserves, the Bundesbank offered the banks, as well as non-banks and private individ-

66 See Monthly Report of the Deutsche Bundesbank 3/1990, p. 22 ff.

uals, 25,000 million of interest-bearing new liquidity papers in three tranches with a life of 3, 6 and 9 months, thus availing itself for the first time of the new Article 49 of the Bundesbank Law. But compared with the total minimum reserves of all American banks in the US Federal Reserve System (about 20,000 million US $), the approx. DM 48,000 million minimum reserves of the German banks are still considerable.

3.2.3. The "lender of last resort" function of the central banks also argues for a retention of compulsory minimum reserves, but at a lower level, Minimum reserves can have a welcome compensatory function where they are used temporarily as "working balances" to bridge over liquidity bottlenecks. This can be seen when stock exchange prices collapse and the banks are suddenly faced with fairly substantial liquidity bottlenecks. If the minimum reserves are not available or are so low that they cover only the minimum balance required for payment transactions, the banks will immediately need greater liquidity assistance from the central bank. Interest rates will be commensurate with the assistance rendered.

3.2.4. The non-monetary policy-based minimum reserves requirement of the Bank of England is another matter. In fact, the minimum reserves obligation of the British banks (down to 0.35%) may be seen as a levy for the supervisory costs of the Bank of England. Corresponding levies are also raised for this purpose from banks in other countries where there are special authorities for bank supervision. Such levies do not seem to influence competition between banks in the internal market. The same applies to the partial "deduction" of the costs of holding minimum reserves from certain payments services of the central banks. Furthermore, the example of the Bank of England shows that under present conditions monetary policy can make do without a minimum reserve requirement.

3.3. If the monetary policy of one or more Member States continues to employ high minimum reserve requirements, such reserves in excess of the 1 or 2% justifiable as a "working balance" should bear interest at market rates.

3.3.1. The banks of the countries concerned would not be at a disadvantage - including in competition with banks in other countries - if that portion of the minimum reserves in excess of the 1 to 2% bore interest. The central banks could, for instance, consider paying interest at the discount rate on all compulsory minimum reserves in excess of 1 or 2%.

3.3.2. Paying interest on minimum reserves is, in a way, inherently contradictory because, from the point of view of the banks, the minimum reserves would then be like a money market investment. However, this "investment" would lack the elements of free choice and instant access. On the other hand, compulsory minimum reserves can also be an inducement to money market transactions if the banks can obtain the funds required to comply with their obligations temporarily and partially on the money market. Compliance with minimum reserve requirements may to this extent involve actual costs and not just theoretical loss of revenue.

3.4. A general reduction of minimum reserve ratios to a low level must be accompanied as speedily as possible by an alignment of the way they are calculated. The minimum reserve ratios for the various types of deposits should also be as uniform as possible and possibly include banks' certificates of deposit, especially as these certificates are a preferred investment of money market funds.

3.5. The reduction of minimum reserve requirements should also include the analogous obligation which still exists in some Member States for banks to invest in central bank certificates of deposit and in government paper. From the beginning of the second stage of monetary union, i.e. from 1 January 1994, the Commission is in any case to monitor the development of government debt (Article 104c(2) of the Maastricht Treaty), with particular reference to excessive budget deficits. This includes central bank overdraft facilities in favour of public authorities which will be prohibited as from that date pursuant to Article 104(1) in conjunction with Article 109e(3).

3.5.1. In preparation for Article 104 the Greek central bank has already reduced the requirement for banks to invest in Treasury bills from a "minimum reserve" of 40% in December 1990 to 15% in October 1992.

3.5.2. In Spain the central bank has announced a systematic abolition of the obligations to invest in certificates of deposit and Treasury bills: these "minimum reserves" in certificates of deposit are to be reduced gradually to 12% in 1993, 6% in 1997 and about 2% in 1999, the "minimum reserves" in Treasury bills from 3.8% in 1992 to 0% at the end of 1996.

3.5.3. An even more rapid general dismantlement of these minimum reserve-like obligatory investments for banks would help to make the central banks' monetary policy more neutral from the point of view of competition.

3.5.4. Article 19(1) of the Maastricht Protocol on the Statute of the European System of Central Banks stipulates that minimum reserve requirements may be imposed "in pursuance of monetary policy objectives"; in other words, minimum reserves may not be used by the central banks to finance public budget deficits or as a source of revenue for the central bank itself.

3.6. With uniformly low compulsory minimum reserves this monetary policy instrument would be ready for use if required by the ESCB, without influencing competition between the banks. There would be little point in totally abolishing compulsory minimum reserves a few years before monetary union if they were reinstated by the ESCB when set up in 1997 or 1999. The basis for minimum reserves and their ratios is to be decided in accordance with Article 19(2) and Article 42 of the ECB Statute.

3.6.1. Moreover, an alignment of minimum reserve requirements at a low level should not have any consequences for Member States whose cental banks do not have minimum reserves as a monetary policy instrument (such as Luxembourg and Denmark). These countries should be free to introduce a minimum reserves policy if such is provided for as part of the creation of a European System of Central Banks.

3.6.2. Keeping open the minimum reserves option should also be seen against the background of liberalized

financial markets which are still willing to innovate and for which the minimum reserves instrument should also be kept in working order. The exchange rate adjustments and dramatic changes in central bank foreign exchange reserves in September and October 1992 also showed that in the internal market minimum reserves can make a welcome contribution to controlling the money supply in the wake of massive inflows or outflows of foreign exchange. Furthermore, the lack of experience with the planned economic and monetary union - common monetary policy with coordinated national economic policy - argue for a monetary policy underpinned by minimum reserve requirements.

3.7. On the other hand it is understandable that the central banks have recently relied more heavily than in the past on open market operations as a monetary policy instrument. An open-market policy offers a full range of options from expanding liquidity to partially reducing it, depending on the volume of money required by the banks. In most Member States open-market policy already avails itself of various options, in some cases simultaneously, i.e. the sale and repurchase of central bank certificates, Treasury bills and other securities. An increasingly important role is being played by the so-called "fixed-rate repos", where the central banks withdraw from the market at a fixed interest rate the securities offered to them by tender.

3.7.1. Open-market operations are also seen as a form of monetary policy consistent with a market economy, after the lifting of the last quantitative credit restrictions at the end of the 1980s (e.g. in 1986 in Italy). An even more intensive use of open-market policy would seem possible in a European System of Central Banks in which the national central banks could play a role in open-market policy (Article 18(1) of the Statute). Under the monetary policy guidelines for the Community which the Governing Council of the ECB is to adopt (Article 12(1) of its Statute), the national central banks would have a certain latitude as to open-market policy in their own particular area, especially in the selection of the appropriate "domestic" securities. The ECB could then concentrate on open-market transactions on the major markets of the most important Community financial centres. However, in view of its scale in a European monetary union, there must be a certain centralizing tendency in open-market policy.

3.7.2. On the other hand, minimum reserves policy, because it necessarily ties all banks directly to their particular national bank, would underline the desired federative nature of the ESCB. The holding of minimum reserves also makes for a rapid and reliable evaluation of the liquidity trend and requirement of each Member State of the ESCB. This can make it easier for monetary policy to control the money supply, which would make for greater monetary and banking stability.

4. Conclusions

4.1. The Economic and Social Committee considers that the basis for minimum reserves should be aligned and the minimum reserve ratios reduced to 1 to 2% of deposits, in all Member States; this should be done as soon as possible without waiting for a common monetary policy in the third stage of monetary union. The reasons for an alignment of minimum reserves systems and for a reduction in the minimum reserve ratios to a uniformly low level of 1 to 2% are set out in points 4.2. and 4.3.

4.2. Different national minimum reserve bases affect competition between Member State banks. The minimum reserve policy pursued in most Member States also affects competition between Community banks and the banks of major non-EC countries, such as Japan, the USA and Switzerland.

4.3. Under normal conditions high minimum reserves - if they are substantially in excess of the working balances at the central bank - raise the cost of the liabilities side of the banking business, restrict their lending to the disadvantage of business customers and private households and work against better terms for their customers.

4.4. If one or more central banks opt to retain higher minimum reserve ratios, interest should be payable at the discount rate on that portion of the minimum reserves in excess of the banks' working balances of 1 or 2% with the central bank, so as to avoid the disadvantages mentioned in points 4.2. and 4.3.

4.5. As a monetary policy instrument, minimum reserves can be a last resort, especially during the completion of economic and monetary union and thereafter for the common monetary policy of the ESCB against a background of convergent national economic policies. To ward off inflationary tendencies, minimum reserve requirements can even be a welcome - from the point of view of monetary stability - monetary policy instrument which influences bank liquidity in a country rapidly and evenly. Complete abolition of minimum reserves as a monetary policy instrument would not therefore appear desirable. However, countries which do not currently have any kind of minimum reserve requirements should be free to introduce them if they are provided for in the ESCB.

4.6. The minimum reserve-like compulsory investments in central bank paper and Treasury bills which still persist in some Member States should be dismantled as quickly as possible. Such compulsory investments serve in practice to finance public budget deficits through the central bank and will not be permitted from 1994.

4.6.1. A rapid general abolition of such compulsory investments would mean that central bank monetary policy had less impact on the competitive position of the banks.

4.6.2. With regard to the post-1994 ban on the financing of budget deficits by the central banks, consideration should be given to a schedule which stretches in part until the end of the 1990s and provides for a phased dismantlement of compulsory bank investments in securities. If the annual percentage increase in the deposits forming the basis for the compulsory investment were greater than the percentage decrease in the ratios, the total amount would not decrease but could even increase.

APPENDIX
Minimum reserve regulations in selected countries

Basis of assessment			Reserve holdings		
Country	**Items subject to reserve requirements**	**Duration of reference period/ reference date**	**Bank assets subject to reserve requirements**	**Period forcompliance with reserve requirements**	**Reserve ratios**
Germany	Deposits and monies received (sight, time and savings deposits up to 4 years, bearer bonds up to 2 years)	1 month	Central bank balances, cash holdings (up to 50% of the required reserve)	Average of 4 weeks, with a 2 week lag between the reference period and the compliance period	Time liabilities and savings deposits: 2% (since 1.3.93), sight deposits: 6.6% for the first DM 10 million, 9.9% for the next DM 90 million, 12.1% for over DM 100 million, sight liabilities vis-à-vis non-residents: 12.1%.
France	Sight deposits, savings deposits, time deposits, etc., up to 2 years	End of month	Central bank balances	Average of 4-week period covering the relevant month ending	1% for sight and savings deposits under 2 years; 0.5% for time deposits up to 1 year; 0% for time deposits between 1 and 2 years and for foreign currency deposits
Greece	Sight, time and savings deposits, including of non-residents	Month	Central bank balances	Average of last month	9% since Oct. 1991 for all deposits (residents + non-res.) on average of last month
Great Britain (1)	Bank liabilities of up to 2 years in £ Sterling	6 months	Central bank balances	The balances are frozen for 2 months at the Bank of England	0.35%
Italy	Changes in sight and time deposits in Italian Lira and net foreign exchange position	End of month, in some cases also 1 month	Central bank balances	Balances to be frozen at the Banca d'Italia at the latest 2 weeks after the minimum reserve requirement is established	25% of growth, until 22.5% of total amount is reached, since 8.2.93 until 17.5% is reached
Japan	Time and other deposits, securities issues, liabilities to off-shore centres	1 month	Central bank balances	Average of 4 weeks, 2 week lag after reference period	Between 0.05 and 1.3%
Canada (2)	Sight and time deposits	1 month	Central bank balances, cash holdings	Average of 2 14-day periods, with time lag after the reference period	Between 10 and 1%
Netherlands	a) Changes in net money creation (after deduction of monetary capital formation) if this exceeds a certain rate	3 months	Central bank balances	The reserves are only fictitious; the banks are charged their cost equivalent	0%
	b) Bank liabilities .		Central bank balances	For 4 weeks	0 to 2.4%
Austria	Sight, time and savings deposits in ATS, certain securities issues, net foreign exchange position	1 month	Central bank balances, balances with central institutions and the Post Office, cash holdings, some Treasury bills	Average of 4 weeks, with lag between reference and compliance period	Between 9 and 4 1/2%

(1) Minimum reserves in GB are not used for monetary policy purposes.
(2) In Canada the possibility of abolishing compulsory minimum reserves is being discussed.

Minimum reserve regulations in selected countries

Basis of assessment			Reserve holdings		
Country	Items subject to reserve requirements	Duration of reference period/ reference date	Bank assets subject to reserve requirements	Period for compliance with reserve requirements	Reserve ratios
Switzerland (3)	Sight deposits, time deposits up to 3 months, 20% of savings deposits	3 months	Central bank balances, balances with central institutions and the Post Office, cash holdings	Average of 4 weeks (from 20th to 19th of following month)	2.5%
Spain	Sight, time and savings deposits and certified banking liabilities of domestic non-banks in Pesetas	10 days	Central bank balances	Average of 10 days, 2 day lag after reference period	3% (1990: min. reserves reduction from 17 to 6%; conversion of min. reserve balances of commercial banks into central bank certificates of deposit bearing 6% interest p.a. and redeemable between 1993 and 2000)
USA (4)	Sight deposits and similar; time deposits not held by private individuals with a term of less and 1 1/2 years, Euro-market liabilities	2 weeks	Central bank balances, cash holdings	Average of 2 weeks; for sight deposits there is a 2 day lag between reference and compliance periods; for other liabilities subject to a compulsory reserve, a 2 week lag	10% for sight deposits, etc. 0% for time deposits and Euro-market liabilities

(3) For Switzerland the data relate to the liquidity regulations.

(4) If the total of all sight deposits of an institution is less than $ 46.8 million: 3%.

OPINION

of the

Economic and Social Committee

on

The analysis of policies to be pursued in the Community during the transitional stage of EMU: secondary legislation

Procedure

On 23 March 1993 the Economic and Social Committee, acting under the fourth paragraph of Article 20 of its Rules of Procedure, decided to draw up an Opinion on:

The analysis of policies to be pursued in the Community during the transitional stage of EMU.

By letter dated 1 October 1993, the Commission sent the Committee, for its members' information, a number of proposals relating to secondary legislation for the implementation of the second stage of EMU, as provided for in the Treaty on European Union (Maastricht Treaty). This Opinion therefore deals with the secondary legislation, and the Committee will issue an additional Opinion on the economic and monetary considerations.

The Section for Economic, Financial and Monetary Questions, which was responsible for preparing the Committee's work on the subject, adopted its Opinion on 5 October 1993. The Rapporteur was Mr MEYER-HORN.

At its 309th Plenary Session (meeting of 20 October 1993) the Economic and Social Committee adopted the following Opinion by a large majority with two abstentions.

1. Preliminary comments

This Opinion deals with the Commission's - initially informal - proposals for secondary legislation implementing the second stage of Economic and Monetary Union. On 22 June 1993 the European Council asked the Commission to submit proposals. Until the Treaty on European Union enters into force, the legislation based on it cannot be formally proposed and adopted.

The necessary discussions with the Community bodies involved (the European Parliament, the Committee of Central Bank Governors, the Monetary Committee) have, however, already started informally, in order to accelerate the subsequent official procedures, to ensure that the legislation can be adopted as soon as the Maastricht Treaty enters into force, and before 1 January 1994.

The draft proposals contained in the Commission Communication of 22 July 1993 (COM(93) 371 final - SYN 466/467) are:

- a Regulation aimed at specifying the prohibition (Article 104 of the Treaty) of public sector access to Central Bank credit, and defining "overdraft facilities or any other type of credit facility", "public undertakings" etc;
- a Regulation aimed at specifying the prohibition (Article 104 of the Treaty) of privileged access for the public sector to financial institutions;
- a Regulation on the application of the excessive deficit procedure (Article 104 c (14) of the Treaty) in accordance with the Protocol, and laying down detailed rules and definitions, including the definition of "public debt";
- a Decision on the statistical data for the establishment of the key for the financial resources of the European Monetary Institute (EMI) (Article 16.2 of the EMI Statute).

2. General comments

The Economic and Social Committee regrets that decisions on secondary legislation are being drawn up in this informal way and in such haste. The decisions on definitions are, in some cases, of great importance for national and regional authorities, for the banking system, for the Central Banks and for public-sector undertakings. The definitions, demarcation lines and procedures must therefore be discussed at length with all concerned and drawn up with great clarity and attention to drafting detail. In some cases, the Explanatory Memorandum declares matters compatible or non-compatible with the Articles containing the definitions, without the reference being covered in the Articles themselves.

The Economic and Social Committee would like to make a number of comments as its contribution to the "informal discussion" of the four proposals for secondary law.

3. Comments on the draft Regulation specifying definitions for the application of the prohibition on direct Central Bank financing of the public sector (Articles 104 and 104b(1) of the Treaty)

3.1. Article 1 and the Explanatory Memorandum state that the Central Banks' credit facilities to the public sector must be repaid or converted into fixed-maturity debt by 1 January 1994. Claims acquired before 1 January 1994 do not count as credit facilities. The draft Regulation therefore confines Article 104 of the EC Treaty to borrowings contracted after 1 January 1994. In view of the large public-sector debt of some Member States, it would be realistic not to require all claims outstanding at the end of 1993 to be repaid, but rather to allow a reasonable period (e.g. 10-15 years) for their conversion into debt instruments.

3.2. Articles 2 and 5 of the draft Regulation provide the useful clarification that open-market operations in government securities in the framework of the Central Banks' monetary policy, and standby credits with the IMF and the EMS, do not fall under the credit facilities prohibition laid down by Article 104 of the Treaty.

3.3. The rules governing the role of the Central Banks as fiscal agents and in the circulation of coins, contained in Articles 3, 4, and 5 of the proposal, do not, on the other hand, appear absolutely necessary.

3.4. The Central Banks maintain accounts in their capacity as fiscal agents for governments, a role specifically

enshrined in Article 104(1) of the Treaty. In the course of daily credit transfers, net debtor positions can arise which are tantamount to Central Bank loans to the public sector. The Commission feels that the very short-term and technical nature of these loans means that they will have practically no effect on the Central Banks' independent monetary policy. However, in order to prevent Article 104 being circumvented, the Commission proposes that loans arising from credit transfers be considered prohibited credit facilities if they are extended overnight (Article 3). Is this appropriate? The Commission itself points out that Article 104 is not intended to hinder the Central Banks' management of payments transactions.

3.5. The same consideration applies to cheque collection. The Central Bank sometimes credits cheques in favour of the government to the government's accounts before the accounts of the private sector drawees are debited. The Commission sees this difference in value dates as constituting loans incompatible with Article 104. Although the effects of this are relatively insignificant, the Commission feels that there is still a need for regulation. Article 4 stipulates that differences in value dates will not be held to constitute prohibited overdraft facilities only if the time lags involved are normal for cheque clearance in the country in question. Is secondary legislation really needed here?

3.6. Coins issued by governments and circulated by the Central Banks are also seen as giving rise to overdraft facilities requiring regulation. In some Member States the value of coins is credited to the Treasury accounts before all the coins have gone into circulation; the Treasury accounts are not debited, however, when reflows to the Central Bank occur.

For practical reasons the Commission proposes (Article 5) that, in general, the Central Banks' stocks of coins should not be regarded as prohibited credit facilities provided that they constitute less than 10% of total coins in circulation.

4. Comments on the draft Regulation specifying definitions for the application of the prohibition of privileged access of the public sector to financial institutions (Article 104 a).

The Explanatory Memorandum states that the prohibition on privileged public sector access to financial institutions is intended to submit the public authorities to market discipline. This in turn is intended to help prevent excessive budget deficits. This is by no means certain, however, given the low interest-rate sensitivity of the public sector.

The enactment of the prohibition on privileged access is of great significance for the whole banking system. It is, therefore, regrettable that important problems are discussed too briefly, and only in the Explanatory Memorandum; the Regulation will therefore only be partially binding therefore.

On the other hand, the operation of the financial system, and in particular public-sector financial institutions, should not be hindered by the definitions (public undertakings, financial institutions, privileged access). This might be the result, however.

4.1. The Explanatory Memorandum to Article 1 excludes from the ban on privileged access:

- certain financial institutions' obligation to finance social housing on special conditions;

- interest subsidies or other transfers from one area of the public sector to another.

This is reasonable as we are dealing with questions of competition and/or prudential supervision, rather than potential obstacles to efforts to achieve improved budgetary discipline which might compromise stability-orientated monetary policy. It is not clear, however, from the wording of Article 1 that the above, referred to in the Explanatory Memorandum, are compatible with Article 104 a of the Treaty.

Another question not addressed in the Explanatory Memorandum is the granting of credit facilities on special conditions to local authorities by their own financial institutions, e.g. local credit institutions. Under the definition proposed in Article 3, this would be classified as privileged (and therefore prohibited) public-sector access to financial institutions, although public-sector budget discipline would in no way be affected. Whether a financial institution incurs higher loan costs for its owners, and in return pays higher dividends, or whether it keeps loan costs down and makes smaller profits has no bearing on budgetary discipline. Funds are merely moved around the public sector without creating credit for the public sector which would affect monetary policy.

Thus, it is debatable whether privileged access should be defined so that loans by publicly owned credit institutions and banks to the public sector fall under Article 104 a, as any loan granted by a publicly-owned financial institution to the public sector, in competition with private-sector banks, would then give rise to suspicion of privileged access.

This would effectively endanger the entire Structural and Regional Policy of the Community and the Member States, as the bulk of funding is channelled to the local authorities and public-sector bodies via specialized - and usually publicly-owned - financial institutions. This also applies to the European Investment Bank's global loans and the channelling of support programme funds via credit institutions. It must be made clear therefore that such cases do not constitute privileged access within the meaning of Article 104 a. It could at the same time be stipulated that the granting of loans and channelling of funds to the public sector must not breach competition and prudential rules. It could also be specifically stated that the proposed Regulation does not prejudice Articles 90 and 92 of the Treaty.

4.2. Article 2 states that prudential measures leading to privileged access are compatible with Article 104 of the

Treaty. This would appear justified, given the prudential treatment of (normally low-risk) claims on the public sector. EC rules which for the same reason give rise to privileged treatment of public debt instruments, and thus constitute privileged access, are also allowed (e.g. lower weighting in the calculation of solvency ratios, diversification requirements for UCITS investment funds).

The reason, based on monetary policy, given for the requirement that financial institutions hold public-sector debt instruments (fifth recital, and Explanatory Memorandum to Article 3(2)) is quite a different matter. The minimum reserve requirements are quoted, under which all credit institutions have to hold part of their deposits with the Central Bank as minimum reserves [65]. The maintenance of such minimum reserves cannot be construed as privileged access.

In some Member States, however, financial institutions are also required to maintain holdings of public-sector debt instruments and/or certificates which the government requires the Central Bank to issue, which are at least like reserves. Such compulsory holdings undoubtedly constitute privileged access, as they amount to the compulsory, long-term placing of public-sector debt instruments with financial institutions. This form of privileged access has clearly been used to finance government budget deficits via the Central Bank, which will in future be illegal [66].

4.3. The Explanatory Memorandum's comments on Article 3(3) are unclear; it is stated that the Central Banks' monetary policy should not be based exclusively on public-sector debt instruments, as is customary with loans at the Lombard rate, loans with securities deposited as collateral and open market operations.

The Central Banks do use these transactions to influence the money supply, either withdrawing liquidity from the economy by the issue or return of securities, or making additional liquidity available by the redemption of securities. This merely entails the temporary change of ownership of public-sector debt instruments, which were previously placed and which were not issued specifically for that purpose. This does not constitute privileged access of budgetary relevance. The exclusive use of public-sector debt instruments for monetary policy does however raise competition and prudential issues.

4.4. Article 4 excludes public-sector postal financial services from the definition of financial institutions within the meaning of Article 104 a. It is conceded in the Explanatory Memorandum that postal financial services are obliged to make funds available to the public sector. This would clearly constitute privileged access of budgetary relevance, as by creating credit, postal financial services can directly contribute to the financing of public-sector deficits. Whether or not postal financial services are sufficiently separate from government makes little difference to their budgetary relevance within the meaning of Article 104 a, as the public sector has privileged access to them, irrespective of their legal or organizational form. Article 4(1) and (2) should therefore be amended to state that postal financial services are indeed financial institutions within the meaning of Article 104 a.

5. Comments on the draft Regulation on the application of the provisions of the Protocol on the excessive deficit procedure (Article 104c (6) and (14))

Article 109 e (4) requires the Member States to endeavour to avoid excessive government deficits. (From the third stage onwards this becomes a Treaty obligation.) Article 104 c (2) charges the Commission to examine compliance with these arrangements and monitor the development of the budgetary situation and the stock of government debt in the Member States.

One of the Protocols to the Treaty on European Union lays down the reference values for the budget policy convergence criteria, as well as a number of definitions and procedures for the transmission of statistical data. In accordance with Article 104 c (4), the proposal contains further details, including more detailed definitions with reference to the European System of Integrated Economic Accounts (ESA) of the Statistical Office of the European Communities (SOEC).

5.1. In Article 1(1), government is sub-divided into: central government, local government and social security funds, as defined in the ESA. ESA definition S62, used by the SOEC and referred to in the Annex to the proposal, defines the local government sub-sector as "those types of public administration whose competence extends to only part of the economic territory". It is not clear whether regional authorities like the German "Länder" or the Belgian "communautés/gemeenschappen" are covered by this definition.

5.2. Article 4 of the proposal requires the Member States to notify the Commission of their planned and actual government deficits and levels of government debt before 1 February and 1 July of each year. They are also required to provide the Commission with "any relevant supplementary information" as it becomes available. These interim reports could be restricted to data relevant to the assessment of trends in the budget deficit, government debt, the relationship between the deficit and public investment and the medium-term economic situation.

The requirement that Member States report planned levels of government debt goes beyond the requirements of the Protocol annexed to the Treaty. This is justified however, as it will enable the Commission, in assessing the budgetary convergence criteria in accordance with Article 104 c (2), to consider whether the ratio of government debt to GDP "is sufficiently diminishing and approaching the reference value at a satisfactory pace".

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65 ESC Opinion on minimum reserves in the context of the Internal Market (OJ No. C 129 of 10 May 1993).

66 Referred to above: see points 1.2., 2.4., 3.5. and 3.5.1. to 3.5.4.

5.3. Article 6 requires the Member States to inform the Commission of payments made or foreseeable in fulfilment of government guarantees or arising from the debts of other sectors taken over by the government. This requirement is also warranted, as it enables the Commission to assess the risk of an excessive deficit.

6. Comments on the draft Decision on the establishment of the key for the financial resources of the European Monetary Institute (Article 16 (1) and (2) of the Protocol on the Statute of the EMI).

The administrative expenses of the EMI are to be funded by the Member States in accordance with the key laid down in Article 29(1) of the Statute of the European System of Central Banks (ESCB) and the European Central Bank (ECB). The proposal does not therefore, as the title suggests, concern the key itself, but rather the statistical data on population, GDP at market prices (GDP mp) and the method of calculation needed for the key.

The definitions used are those of the ESA and Article 2 of Council Directive 89/130 EEC. The draft proposal therefore contains little that is new. More weight is given to the statistical data for the ESCB and ECB key, which is then to be applied to the Member States' contributions to the EMI's capital, the weighting of votes, the pooling of foreign exchange reserves and the distribution of profits and losses.

6.1. German GDP mp for the period before unification is to be calculated as follows (Article 6): notional GDP mp figures for the former GDR will be added to those of the old Federal Republic for the period 1987-1990 on the basis of the respective 1991 GDP shares of the old and new "Länder".

Although not historically accurate, this device would appear a suitable basis for calculating Germany's contribution to the financing of the EMI.

6.2. The key for individual Member States' contributions (Article 8) is to be the arithmetic mean of the shares of the corresponding Member State in the population and GDP mp of the Community, calculated on the basis of the five-year average (1987-1991) (Articles 4 and 7). The GDP mp data are to be converted into ecu at the average exchange rates of all the working days of each year, as published in the "C" edition of the Official Journal. The accuracy of this method of calculation is reflected in the fact that the weighting of the national Central Banks in the key is to be calculated to four decimal places (Article 9).

As the key is to be applicable for the "entire lifetime of the EMI and will be calculated once only, the Commission and Eurostat must ensure that the GDP mp data are in fact compiled in accordance with the uniform procedure (Article 2) laid down in Council Directive 89/130 EEC and that the economic aggregate calculations are compatible.

OPINION

of the

Economic and Social Committee

on the

Proposal for a Council Regulation on Community action in the field of statistics

(COM(94) 78 final)

Procedure

On the 30 March 1994 the Council decided to consult the Economic and Social Committee on the:

Proposal for a Council Regulation on Community action in the field of statistics (COM(94) 78 final).

The Section for Economic, Financial and Monetary Questions, which was responsible for preparing the Committee's work on the subject, adopted its Opinion on 12 April 1994. The Rapporteur was Mr MEYER-HORN.

At its 315th Plenary Session (meeting of 27 April 1994), the Economic and Social Committee adopted the following Opinion unanimously.

1. Legal basis of the Regulation

1.1. The European Commission has submitted a proposal for a Council Regulation (COM(94) 78 final) concerning Community action in the field of statistics.

1.2. The legal basis for the Regulation is Article 213 of the Treaty establishing the European Union, and it will be passed once the Economic and Social Committee, the European Parliament and the European Monetary Institute have given their Opinions.

1.3. The proposed Regulation was drawn up in consultation with the Statistical Programme Committee, the Committee on Monetary, Financial and Balance of Payments Statistics and the European Advisory Committee for Statistical Information in the Economic and Social Spheres.

1.4. Article 23 states that the Regulation is to come into effect 20 days after publication in the Official Journal of the EU and then has immediate legal force in every Member State.

2. Purpose of the Regulation

2.1. For decisions to be made, the European Union requires Community statistics which are up-to-date, reliable, meaningful and comparable from one country to another. Community statistics are particularly essential for the following purposes:

2.1.1. To prepare and achieve Economic and Monetary Union (e.g. financial and monetary indicators for convergence criteria; national accounts, purchasing power parities, consumer-price indices, balance of payments, banking, interest-rate and monetary statistics for the European Monetary Institute).

2.1.2. To promote economic and social cohesion (e.g. GDPs of the regions, unemployment rates, regional indicators on active population and employment in order to assess eligibility for Structural and Cohesion Fund assistance, REGIO database).

2.1.3. To create a European financial area (e.g. capital market statistics, including data on ecu bond issues, databank on all ecu statistics).

2.2. In its Final Report of the Statistical Programme 1989-1992 (COM(93) 454 final), the Commission points to the progress already made in these areas of statistics (chapter I B 1 to I B 4, I C 1). In particular, work done over ten years has brought the European System of Integrated Economic Accounts (ESA) into line with that of the United Nations (SNA) and the methods used by the IMF to measure balance of payments. Within the ESA, collection of the now largely comparable data has been speeded up and provision made for the subsequent inclusion of Austria, Switzerland, Sweden and Finland.

2.3. Community statistics are based on the data supplied by statistical offices in the Member States. This is in line with the subsidiarity principle, which, particularly in the field of statistics, has been proving its worth for some time now. However, subsidiarity also involves the following requirements:

2.3.1. There must be a clearly defined division of responsibilities between the Statistical Office of the European Union (Eurostat) and the statistical authorities of Member States.

2.3.2. Member States must ensure that data passed on from their own authorities to the European Commission conform to principles agreed upon at Community level.

2.3.3. Confidential statistical data must be protected in equal measure at all levels to maintain the confidence of those required to provide information.

2.3.4. Arrangements must be made to ensure that non-confidential Community statistics - are accessible to all citizens of the EU and not just to a small group of immediate users.

2.3.5. In response to the particular needs and the responsibility which the European Monetary Institute (EMI) or, at a later stage, the European Central Bank will have for certain statistics, a special form of cooperation must be agreed upon between the various statistical authorities at national and Community level, taking full account of the independent status of the European Central Bank and the EMI.

2.4. The proposed Regulation implements the measures necessary to meet the requirements set out in point 2.3. The ESC therefore endorses it while making the comments set out in paragraphs 3 and 4 below.

3. General Comments

3.1. The 23 Articles of the proposed Regulation lay down unified standards and harmonized methods for the preparation, collection, storage, processing, compilation,

analysis and dissemination of Community statistics. Multi-year statistical programmes, periodically updated if necessary, are to be set up together with guidelines and objectives, on the basis of annual work programmes.

3.1.1. The Committee welcomes the fact that the proposed Regulation also takes account of both financial constraints at national and Community level and the relevance of Community legal provisions governing such actions (Article 4). In this connection, the ESC particularly approves of the following principles (Article 9(2) points 3 and 4):

3.1.1.1. The financial burden on respondents is minimized.

3.1.1.2. The amount of work and the cost involved in the production of Community statistics must be in proportion to the importance of the results/benefits sought.

3.1.2. In view of the extent and importance of the statistical programmes, the ESC thinks it right to consult the committee specifically set up for this purpose within Eurostat (the Statistical Programme Committee), the European Monetary Institute and, where appropriate, the Committee for Statistical Information in the Economic and Social Spheres and the Committee on Monetary, Financial and Balance of Payments Statistics (Article 3(2) and (3)).

3.1.3. According to Article 3(2), the Commission is to take the statistical requirements of the European Monetary Institute into consideration "as far as possible". The ESC feels that this qualification is inappropriate given the importance of the statistics which will presumably be required when laying the foundations of the common monetary policy, adjusting instruments of monetary policy and promoting closer cooperation between central banks.

3.2. Article 9 of the proposed Regulation states that Community statistics shall be produced in an objective manner, uninfluenced by political or other interest groups. In view of the importance of statistics in the process of completing economic and monetary union (cf. points 2.1.1. and 2.1.2.), the ESC endorses this principle, as well as the detailed rules on statistical confidentiality and protection against unauthorized disclosure (Articles 13 to 19). On this point, the ESC feels that suppliers of statistical data should be informed about the protective measures taken as well as about the legal basis and purpose of the statistics.

3.3. With the implementation of convergence and recovery programmes and plans for closer coordination of national economic policies under multilateral supervision, it is essential that the relevant economic and social interest groups, especially the social partners, are kept informed. The ESC therefore welcomes the fact that the proposed Regulation guarantees impartial and therefore unhindered access to Community statistics which are not subject to statistical confidentiality (Articles 10 and 11).

3.4. The ESC is assuming that it will continue to be consulted on the multiannual Community statistical programmes referred to in Article 2(1) of the draft Regulation

4. Specific comments

4.1. Although national authorities are normally responsible for carrying out the work required under the statistical programme, Community statistics may also be produced by Eurostat with the agreement of these national authorities. The ESC feels that it makes sense to provide for this option (Article 7).

4.2. Article 11(4) states that the conditions of access for statistics' users shall be governed by the tariff policy of each authority and based on mutual information and cooperation between national and Community statistical authorities. This is in line with the principle of subsidiarity. However, the ESC is adamant that cooperation should produce a tariff policy which ensures that the citizens of one or other Member State do not have to pay considerably more than others for access to Community statistics.

4.3. Article 18 states that employees of national authorities will continue to be subject to the ruling on statistical confidentiality even after the cessation of their functions. The ESC welcomes this, but wonders how it can be incorporated into contracts of employment or civil service and criminal law at national and Community level.

4.4. Article 20 lays down the rules for consultation of the Statistical Programme Committee (SPC), particularly the voting and decision procedure for Commission measures which are not in accordance with the opinion of the SPC. The procedure is complicated, but the ESC feels it is indispensable if the decisions necessary for the production of Community statistics are to be taken without long delays. The same goes for rules laid down in Article 21 on the functioning of the Committee on Statistical Confidentiality established under Council Regulation No. 1588/90 of 11 June 1990.

European Communities - Economic and Social Committee

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