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Economic & Monetary Union: the first six months

The third Stage of Economic & Monetary Union [EMU] began on 1 January 1999. This Paper looks at developments in its first six months. It looks at the impact it has had on industry and on the city of London and financial services generally. Lastly, it describes the organisation and work of the European Central Bank and discusses the issue of secrecy and accountability with respect to this most important institution.

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Summary of main points

The dreams of many European politicians and civil servants of closer monetary integration were realised on January 1 1999 when eleven countries, Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Portugal and Spain, irrevocably tied their currencies to the new currency, the euro (€) and the Third Stage of Economic & Monetary Union [EMU] began. Compared to the United States the new euro-zone is slightly the larger in terms of population but rather smaller in terms of GDP. The euro-zone is a more open as an economic area than the US, with exports from the euro-zone about 50% more significant than in the US.

The changeover to the euro went more smoothly than had been expected. In London private sector banks and the Bank of England were able to send their staff home early on the changeover weekend as all procedures worked properly. According to Reuters the massive redenomination exercise, covering more than one billion bonds, securities, contracts etc was completed seven hours ahead of schedule. Since then the main banking and payment system – TARGET- has worked well.

The impact of EMU on sectors of the economy has varied. A Commission study found that the euro provided the focus for a general review of business activity in much the same was as the coming millennium had. Companies and institutions have undertaken reviews and rethinks simply because of the irresistible nature of something so special and unusual.

In the UK companies, have longer to adjust to the new circumstances but some of the larger companies have already altered their systems to cope with the euro. For smaller companies, however, there is growing evidence that the impact of the euro has been limited.

The impact of EMU was more noticeable in financial markets. The abolition of national currencies in participating countries made some changes necessary. Furthermore, the euro itself is a new tradable currency, which may play a different role in the currency markets - or the debt markets - from that of the former national currencies individually or taken together

Although it is still ‘early days’ it looks as though the UK’s non-participation in EMU has not adversely affected London’s position as a leading international financial centre. There is no evidence of a net shift of activity out of London, but there are reports that firms are showing a tendency to consolidate into major financial centres at the expense of smaller euro-area centres.

Inflation and economic activity have been low in the euro zone and for virtually all of the first six months of its existence the euro has traded below its opening value against other currencies, reaching a low point against sterling of 64.14 pence on 4 June 1999: a decline of 9.1% in just over six months

CONTENTS

I Introduction

For more than twenty years many European politicians and civil servants harboured dreams of closer monetary integration between their respective national economies. Some were attracted by the idea of forming an alternative to the influence of the world's dominant currency, the US dollar. Some have been attracted by the advantages that a single currency would bestow. Others have argued for it on the grounds of political symbolism, while yet others have seen it as a way to import an economic model that has worked successfully in the major economy of Europe: Germany. Whatever the motivation this dream was partly realised when the Third Stage of Economic & Monetary Union [EMU] began on January 1 1999.

The purpose of this Paper is to look at the immediate impact of the launch of the euro and at the euro-zone economy during the first six months of its existence. It will also look at the constitution, organisation and decisions of the European Central Bank [ECB] and it will present some views on the likely impact of the euro on key financial markets.

II The Euro Arrives

A. The Changeover

1 January 1999 saw the start of the third stage of Economic & Monetary Union (EMU). Eleven countries, Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Portugal and Spain, irrevocably tied their currencies to the new currency, the euro (€) at the exchange rates shown in the table below:

Euro currency rates

One euro equals:	
13.7603	Austrian schillings
40.3399	Belgian francs
1.95583	German d'marks
5.94573	Finnish markkas
6.55957	French francs
0.787564	Irish pounds
1936.27	Italian lire
40.3399	Luxembourg francs
2.20371	Netherlands guilders
200.482	Portuguese escudos
166.386	Spanish pesetas

Source: European Commission

The rates are shown to six significant figures as required in the regulations. Conversions between currencies should be calculated by first converting into the euro and then out of it to the second currency. This is required to avoid rounding errors etc. There are therefore, no official cross rates although these can be calculated unofficially.

In some respects the start of Stage Three was something of a non-event. For a development of such potential significance – possibly only the post-war Bretton Woods accord comes close in terms of importance - there was very little to report. The experience of City firms was that the changeover had gone more smoothly than had been expected. Private sector banks and the Bank of England were able to send their staff home early on the changeover weekend as all procedures worked properly. According to Reuters the massive redenomination exercise, covering more than one billion bonds, securities, contracts etc was completed seven hours ahead of schedule. One City commentator was quoted as saying that "we had a few glitches where we took a few minutes to think about what to do, but I can't even think of anything I would describe as a problem".[1]

The main technological challenge was whether the new banking payments system would operate efficiently. Named TARGET, the system links up national payments systems in all member states and allows settlements between institutions to be made gross at any time during the day. Unlike previous systems which netted off claims at the end of the day the new system permits gross payments at any time. The fact that settlements are made gross means that there is a greater need of liquidity in each of the fifteen markets and, hence, a higher possibility that one sector could fail and thus derail the whole system. In fact there were few problems. On the first Monday TARGET announced a three and a half-hour extension time to process payments and on the following day another one-hour extension was announced to cope with problems that had occurred at the Portuguese 'hub'. Since then the system has operated within its normal parameters. In its February Monthly Bulletin the ECB noted that:

> On average, TARGET, as a whole has processed payments worth around 1,000 billion every day, an amount that is comparable with the Fedwire system in the United States. This represents a substantial increase in the value of payments processed in the real time gross settlement mode in EU countries (which was around 650 billion on average per day in 1998.
>
> …
>
> Overall, the technical performance of TARGET throughout the first month was satisfactory and, with the exception of a major breakdown in the hardware of one national Interlinking component on 29 January 1999, the system has proven to be reliable from a technical point of view. In a few financial centres some difficulty was experienced during the first week in redistributing liquidity at the end of the day. [2]

In its first Annual Report the ECB commented that:

[1] 'Smooth conversion' *Financial Times*, , 7 January 1999

[2] European Central Bank, *Monthly Bulletin*, February 1999, p 10

> The transition to the euro by the banking and financial sectors of the participating member states in only three and a half days after the irrevocable fixing of the euro conversion rates was deemed to be a remarkable success.[3]

The Bank of England echoed this view in its assessment of the conversion weekend. With particular reference to activity in London it noted:

> The conversion weekend… was one of the biggest logistical operations that the London market has ever undertaken. An estimated 30,000 people were at work in London during the weekend. In addition to normal end of year processing, market firms had to activate changes in their systems to enable them to trade in euro, and to make and receive payments in euro, from 4 January. Many cash balances in participating national currencies had to be converted, and a large number of (mainly government) securities holdings had to be redenominated, using slightly different methods for different participating countries.
>
> Despite the scale of the exercise, the conversion weekend in London went well. Key market firms all completed their changeover operations in good time. There were no significant problems in London, nor within the euro area. Given the unprecedented nature of the undertaking, it was important that contingency planning arrangements were in place, both at the level of individual market firms, and among the authorities in case systemic issue arose. But in the event, they did not have to be used.[4]

The start of Stage 3 also saw the creation of a new exchange rate mechanism (ERM II) to replace the previous system that existed in Stage 2 and which had formed the basis of one of the convergence tests for EMU membership. Currently only two member states participate in ERM II – Denmark and Greece. The Krone participates within a ± 2.25% fluctuation band against the euro and the Drachma participates within a ±15% band.

B. The Impact on Industry

The impact of the euro on sectors of the economy has varied. As part of the preparations for the transition to the euro, the European Commission conducted a study on the practical consequences of this transition for small and medium-sized enterprises (SMEs). Thirty-five SMEs of different sizes, located in the 15 Member States and representing a wide variety of economic sectors were selected to participate in the study. On the basis of these case studies it is clear that for many companies the euro has provided the focus for a general review of their activities, their way of operating, their business strategy and the way in which they will do business in the future. Thus the euro has acted in a similar way as the coming millennium has. Many companies and institutions have undertaken

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3 *1998 Annual Report*, European Central Bank

4 *Practical Issues Arising from the euro*, Bank of England, June 1999

reviews of "X in the 21st Century" simply because of the irresistible nature of something so special and unusual.

The table below summarises the findings of this study based on a random sample of the companies contained therein. The impact of the euro is graded on six areas of activity from 'low' to 'high' and an overall assessment is then given.

Impact of the introduction of the Euro: selected companies

		Area of impact					
Company/ Sector	**Overall**	**Customers**	**Products/ Services**	**Suppliers**	**Partners**	**Organisation**	**Competitors**
Galler / chocolate	high	high	high	low	low	medium	low
Blue Line/ uniforms	medium	low	low	medium	low	high	low
Guy Rollinger/ construction	medium	medium	low	high	low	medium	medium
Marshalls/ supermarket	high	high	medium	medium	medium	high	medium
Regnault Tourisme/ coach operator	high	high	medium	high	low	high	medium
Vicente Puig Oliver/ doormaker	low	low	low	low	low	high	low
ESSE EMME Assicurazioni/ insurance	low	medium	low	low	low	medium	medium

Source: European Commission, *Your business & the euro*

Some of the results are a surprise. It seems strange that the euro has made more of an impact on a medium size grocery store in Ireland (Marshall's) than it made on an Italian insurance company. Some of this may be due to perception – the survey results depended partly upon self analysis of problems generated by the euro. But, it is clear that for small firms the response they needed to make, or perhaps more accurately, the response that they thought they needed to take, has occupied considerable amounts of management time and energy. The actions taken and the response made by the Luxembourg company Guy Rollinger are typical of several in the survey.

According to the Commission's study Guy Rollinger is a construction, real estate and environmental protection company founded in 1982. It has 180 employees and a turnover of about £5.5 million in 1997. Its response to the impending arrival of the euro is summarised below:

> Guy Rollinger aims to use the transition to the euro as an opportunity to reinforce its market image as a flexible and customer focused organisation. It will also take a pro-active approach towards the strategic opportunities and challenges created by EMU.
>
> To achieve these objectives, Guy Rollinger intends to:
>
> - Provide euro services as of 1 January 1999. To be able to do so, Guy Rollinger has taken the necessary steps to make its IT systems euro-compliant. It will also provide employees with the necessary euro training.

> - Monitor competitors' prices and the impact of the increased price transparency.
>
> - Identify cheaper supplier opportunities abroad.
>
> - Analyse the new investment and financing opportunities created.
>
> - Follow-up the development of new psychological prices in euros and adapt its prices accordingly.
>
> Internally, Guy Rollinger will adopt the euro as the operating currency on 1 January 2001.

Of the other companies in the survey, Galler has already adopted the euro as its operating currency as of 1 April 1999, Regnault will do so on 1 January 2000, EMME intends to on 1 April 2000, Luvipol will "in the course of 2000" and, lastly, Marshall's will adopt the euro as the operating currency in late 2001.

UK companies, because they are one stage removed from the euro, have longer to adjust to the new circumstances. However, some of the larger companies, particularly those with overseas branches have had to react. According to an FT survey of exporters the following companies have altered their systems to cope with the receipt of, and invoicing in, euros: BP, Rover Group, British Steel, Texaco, ICI (who expressed a definite preference for dealing in euros), Unilever, GKN, Vickers and Siemens.[5] For smaller companies, however, there is growing evidence that the impact of the euro has been something of an anti-climax.

An article from the Financial Times quotes the experience of a medium-sized (turnover £2 million) manufacturing company that had taken what the Commission in its study (see above) would have called a pro-active approach to the euro.

> In the days between Christmas and the New Year, Colin Scarsi, managing director of Green Tyre, an environmentally friendly tyre producer, slogged away in his office to produce a euro price list for all his continental markets.
>
> As the euro went live, he was ready for action, with a euro price list, a euro friendly computer system and a euro bank account, opened at the Newcastle branch of the Bank of Scotland. Four weeks later, he is still waiting for something to happen. Not one cent has passed into his euro account. "All I've got is probably more bank charges," he says ruefully.[6]

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5 *Financial Times*, 30 October 1998
6 *Financial Times* 28 January 1999

A follow-up article that characterised matters under the heading – " The great euro yawn sets in" quoted various business organisations and trade bodies whose experience had been that there has been "a slowdown in interest in the euro".[7] One study found that:

> UK organisations planned to spend 6% of the information technology budgets on euro related services last year, but actually spent only 1.4%. that is expected to grow to 3% this year. But the proportion of companies that say they will be making no changes has risen from 42% to 50%.[8]

The impact of the start of the euro has been most pronounced with respect to financial service companies. This is briefly examined in the following section.

C. The Impact on the Financial Markets

The launch of the single currency in the Euroland countries seems likely to change the structures of European financial markets in a number of ways. Some of these changes follow necessarily from the abolition of national currencies in participating countries. In the foreign exchange markets, for example, trades between participating currencies are no longer possible now that national currencies are in effect denominations of the euro. On the other hand, the euro itself is a new tradeable currency, which may play a different role in the currency markets - or the debt markets - from that of the former national currencies individually or taken together.

Other changes may be expected if the single currency has the effect of turning the euro zone countries into an area which is treated as a single market by investors and borrowers. An economic area of this size presents opportunities for integrating national and regional markets, with anticipated benefits of increased liquidity and depth, and economies of scale. Market participants may choose to operate in different types of markets than those which they have previously used, taking advantage of the removal of currency risk. New types of market may also develop, which were not previously economical or globally competitive in the smaller pre-euro market place. All these changes present a challenge to financial centres and to market participants, who must ensure that they do not lose business to their competitors as a result of these changes, but who will also want to compete to increase their share of current business and to take on new types of business.

Although the UK is not participating in the single currency, it is important that it responds to the challenges of the single currency to maintain and develop the City's position as the leading international financial centre in the European time zone.

7 op cit 24 May 1999
8 ibid, Quoted from a report published by International Data Corporation

It is probably too early to tell how successful this effort has been. However, the Bank of England reports that ‘there is quiet confidence among international market firms that London has been maintaining its market share since the launch of the euro’.[9] It notes that it is increasingly difficult to define where financial activities take place since cross-country teams may work on a single transaction, and many firms enjoy remote access to overseas exchanges and systems. There is apparently no evidence of a net shift of activity out of London, but there are reports that firms are showing a tendency to consolidate into major financial centres at the expense of smaller euro-area centres. If the location of staff is used to determine where financial activity takes place, London remains the base for much activity on the euro wholesale markets. Early signs are that the largest firms have been the main beneficiaries of the introduction of the euro: if so, London will benefit to the extent that many of these firms have their European headquarters in London.[10]

The Bank of England’s enquiries as to what factors will dictate whether market firms will choose to remain in London suggest that international competitiveness is vital, of which participation in the euro area is only one of several factors.

1. Foreign exchange markets

London is the largest centre for foreign exchange activity in the world. The latest survey by the Bank for International Settlements estimated that the average daily turnover for traditional global foreign exchange instruments was $1,490 billion in April 1998. The UK’s share of this market was 32%, well above the second placed country, the US, which had 18% of the market. The UK’s share has increased since the last survey in 1995.[11] The UK is also predominant in the Over The Counter (OTC) and interest rate derivatives markets (36%).

The Bank of England reports that London has maintained its market share in the foreign exchange markets since the launch of the euro, but that volumes, which were low before the conversion weekend, have remained on the low side subsequently:

> Average daily volume in spot /$ foreign exchange in EBS averaged $38 billion in the first quarter of 1999, compared with an average daily volume in the former national currencies against the dollar of $46 billion in 1998. EBS is estimated to account for around one-third of the spot /$ foreign exchange market, and /$ transactions represent around 50% of total average daily foreign exchange volume in EBS. London’s market share of global euro spot transactions in the first quarter of 1999 is estimated at a third, the same as its share of national currency transactions in 1998.[12]

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9 Bank of England, *Practical issues arising from the Euro*, June 1999, p 14
10 Ibid.
11 Bank for International Settlements press release, ‘Central bank survey of foreign exchange and derivatives market activity in April 1998: preliminary global data’, 1998
12 Bank of England, *Practical issues arising from the Euro*, June 1999, p 25

A number of reasons are thought to account for the low turnover in euro foreign exchange. These include the fact that the business which used to exist between the eleven participating currencies has obviously disappeared with the disappearance of those currencies. Moreover market conditions at the end of 1998 have led some firms to scale back their trading activity; others have opted for longer-term maturities to reduce their need to participate in the early days of the euro markets. Despite the low turnover, the euro market has been liquid and price spreads, a reliable indicator of activity, have been narrow.[13]

2. Futures markets

Ahead of the single currency, attention focused on which of the European futures exchanges would capture the market for short-term interest rate (STIR) contracts. In these markets there is thought to be room for only one dominant contract. LIFFE, the London Financial Futures and Options Exchange, initially referenced its STIR contracts primarily against the British Bankers' Association's Euro Libor rate, although it also offered contracts based on a competing rate, Euribor, which is set by the European Banking Federation (EBF).

The markets showed a strong early preference for contracts in Euribor rather than Euro Libor products.[14] This was interpreted by some as a sign that London had lost out: the benchmark short-term interest rate contract in pre-euro days was referenced against a UK Libor rate. LIFFE had, however, included a provision in its rules to change the reference rate of its contracts if that were to be in the best interests of the market as a whole.[15] Two days of voluntary conversions in mid-January and mid-February 1999, during which investors were able to convert their Euro Libor contracts into Euribor equivalents, free of exchange fees, allowed LIFFE to consolidate its position in the short-term interest rate market.[16]

> The second voluntary conversion further consolidated LIFFE's position as the leading market for European exchange-traded STIR derivatives. LIFFE's market share of major European STIR futures volumes has been steadily over 75%, and currently stands at over 85%. At the end of May, open interest in LIFFE's Euribor contract was twice as large as its euro Libor contract and some seven times larger than the comparable contract on Eurex [the Frankfurt exchange][17]

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13 Bank of England, *Practical issues arising from the Euro*, June 1999, pp 25-26
14 'City losing out to Brussels in fight over euro benchmark', *Financial Times*, 8 January 1999
15 LIFFE press release, 'LIFFE is ready for the Euro', 30 December 1998
16 LIFFE press release, 'LIFFE raises Euro money market business to over euro2,000bn', 18 February 1999
17 Bank of England, *Practical issues arising from the Euro*, June 1999, p 29

During June 1999, the average daily nominal value of Liffe's 3-month Euribor contract was £130 billion.[18]

3. Corporate bonds

One expected consequence of the single currency was the creation of a Europe-wide market for corporate debt. Although there is already a very substantial market for eurobonds - that is, bearer bonds denominated in European currencies - relatively few bonds have been issued by European companies, except the very largest companies, as a borrowing tool. This contrasts with the position in the US, where companies are major issuers of bonds. The advantages for companies of borrowing in this way are access to debt at prices which are cheaper than bank borrowing, and on terms which are often less onerous to comply with. The US corporate bond market is very large and also very liquid.

Expectations that the creation of a large single currency market would foster the development of a pan-European corporate bond market seem, on early evidence, to have been correct, but the speed with which the market expanded has exceeded market expectations. In the first quarter of 1998, 6% of euro-denominated bonds were issued by corporate borrowers. In the first quarter of 1999, corporate issuers represented 12% of this market. The Bank of England reports:

> Non-financial sector corporate bond issuance in euro rose from the equivalent of €10 billion in 1998 Q1 (for the 11 former national currencies combined) to €31 billion in 1999 Q1, according to data supplied by CDB. This is a considerably faster rate of growth than that seen for international capital market corporate issuance in other currencies, and represents one of the most significant trends to emerge in the euro capital markets to date. Market firms also point to a marked increase in average individual size in the euro corporate bond market as important in helping to improve liquidity.[19]

It is expected that the euro corporate bond market will continue to grow, and that companies will increasingly use the market as an alternative to bank finance. If this development is sustained, this will represent a major structural change in European corporate finance.

Corporate bonds are also being used to fund mergers and acquisitions in the European economy, where a great deal of industrial consolidation, stimulated by both the single market and the start of EMU, is taking place.

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18 LIFFE press release, 'LIFFE trades £263 bn per day in June 1999', 2 July 1999
19 Bank of England, *Practical issues arising from the Euro*, June 1999, p 35

4. Equities markets

On the London International Stock Exchange about 42% of turnover in the first quarter was denominated in euro, as against about 32% in sterling. This reflects the volume of international business which is transacted on the London exchange. Many international equities have already begun trading in euro denominations on the LSE, and Irish and UK equities can be converted into euro prices where there is market demand for this.[20]

In equity markets, as in the debt and foreign exchange markets, the single currency is only one driver of change. The development of the single currency zone coincides with trends towards international coverage and global consolidation in financial marketplaces; these are in part driven by technological advances such as remote access to overseas markets and the increased use of the internet.

As a response to these stimuli an Alliance was announced in July 1998 between two of the largest European stock exchanges (by capitalisation of domestic equities), the London Stock Exchange and the Deutsche Börse, which is based in Frankfurt. Their strategic alliance has already given members of both exchanges common access to each market. Six other exchanges - those in Amsterdam, Brussels, Madrid, Milan, Paris and Switzerland - have now also joined this European Alliance. To date only limited harmonisation - of trading hours, for example - has been agreed, but further proposals are under development.[21] Some have questioned whether the Alliance is developing fast enough to keep up with recent changes in share trading, such as internet-based trading.[22]

There are some signs that investors will increasingly analyse and invest in companies on a pan-European sectoral basis rather than on a country basis as is currently the case. The removal of currency factors from euro zone investments encourages this development. This suggests that equities markets will need to become more integrated if they are to match the needs of investors.

The Alliance of exchanges intends to trade Europe's top 300 companies on a common trading platform across Europe. The creation of such a platform, if achieved, may mean that the equities market in Europe splits into a two tier system, with trading and liquidity concentrated in these very large stocks. This might have an adverse effect on companies which are currently significant in national markets but which are too small to qualify for the new platform. Competition is already keen among index providers to establish an index for European equities.[23] Such an index would act both as a benchmark for European equity price movements and would be used to reference derivative products

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[20] Bank of England, *Practical issues arising from the Euro*, June 1999, pp 40-1

[21] London Stock Exchange press release, 'Market harmonisation details confirmed', 17 June 1999

[22] 'Race to save the "superbourse" speeds up: Rapidly advancing technology means those developing the pan-European stock market may have to hasten their efforts', *Financial Times*, 7 June 1999

[23] 'Battle of the equity benchmarks hots up', *Financial Times*, 25 May 1999. The competing index providers are FTSE International, Dow Jones and MSCI.

such as futures and options. Whichever index becomes the index for the Alliance - whether officially or as the choice of market users - would be in a very strong position to close out its competitors, although different users may still require different indexes.

III Economic Developments

A. The Euro-Zone

As a background to events of the last six months it is helpful to compare the size and make up of the euro-zone to the other dominant force in the world economy – the United States. The following statistics were prepared by the ECB and appeared in their first monthly report. They illustrate both similarities and distinct differences between the two blocs.

Euro-zone & United States Compared

		Reporting period	Unit	Euro- zone	United States
Population	(1)	1998	millions	292.0	270.0
Share of world GDP	(2)	1997	%	15.0	20.2
Exports of goods		1997	% of GDP	13.6	8.5
Imports of goods		1997	% of GDP	12.0	11.1
Exports of goods		1997	% of world exports	15.7	12.6
Real GDP growth		1998	%	3.0	3.3
Consumer price inflation	(3)	Nov-98	%	0.9	1.5
Unemployment		Nov-98	% of labour force	10.8	4.4
Short term interest rates		end 1998	%	3.3	5.0
10 yr government bond yields		end 1998	%	3.9	4.7

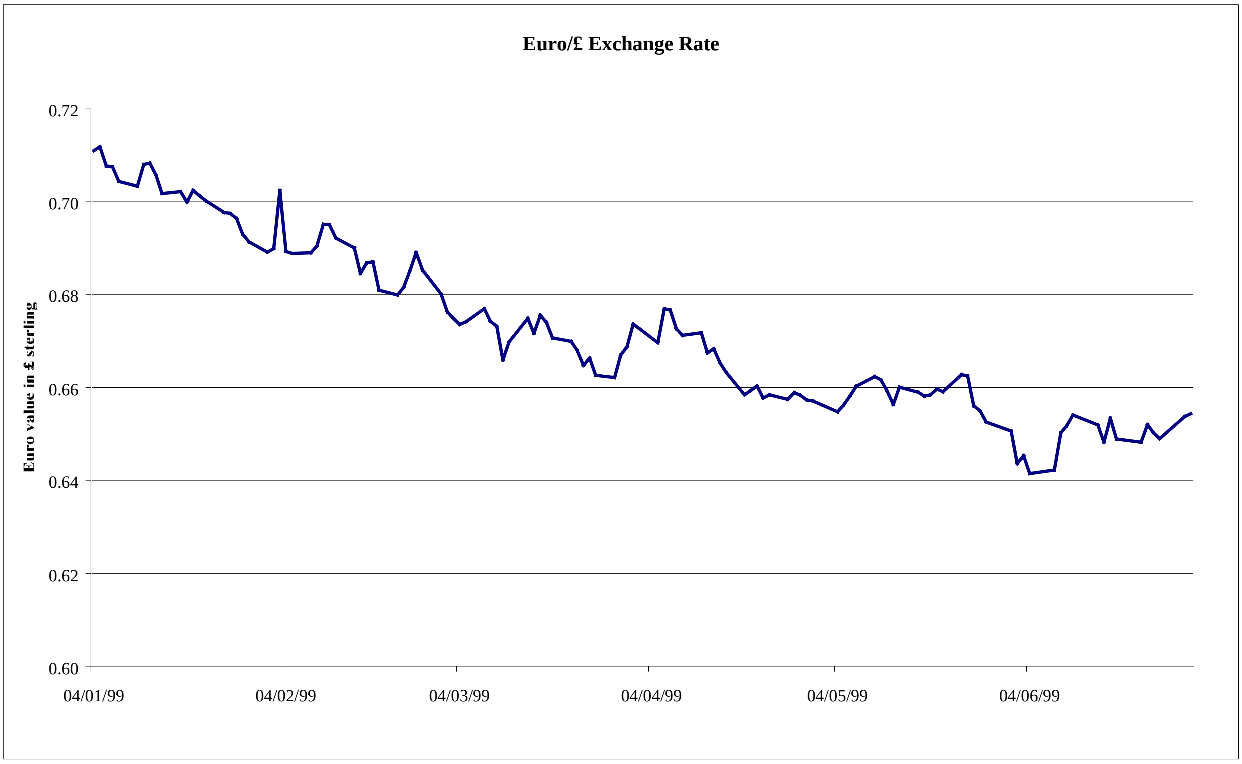
Notes: (1) constant prices and ppp's
(2) excludes intra-euro trade, exports f.o.b; imports c.I.f
(3) Harmonised index in euro-zone

Source: European Central Bank, *Monthly Bulletin* January 1999

The euro-zone is slightly the larger of the two in terms of population but rather smaller in terms of GDP. The euro-zone is a more open as an economic area than the US, with exports from the euro-zone about 50% more significant than in the United States. The table also highlights the current differences in the economic state of the two areas. Both interest rates and inflation in Europe are below those in the United States; a reflection in part of the relatively depressed state of Europe a position that is highlighted by the unemployment rate,which is over twice that of the United States.

B. The euro

Apart from a brief period at the start of its life the euro has generally traded well below its opening value of €1.1743 to the dollar and €0.7058 to the pound. A chart showing the value of the euro against sterling since its inception is shown on the following page.



The euro reached a low point of 64.14 pence on 4 June 1999: a decline of 9.1% in just over six months. The ECB noted that the euro-zone currencies had, in 1998, appreciated by about 2% against both the dollar and sterling.[24] The implication being that a moderate weakening was to be expected. The ECB has suggested that developments since the start of the year owe more to the strength of the US dollar (which in turn has pulled up sterling) than any fundamental weakness of the euro. The buoyant state of the US economy allied to the absence of inflationary pressures has created conditions for strong positive sentiment for the dollar. More recently a rise in oil prices following demand for fuel in the Balkans and the traditional link between sterling and the dollar has acted to support sterling.[25] Given the frequency with which a currency's value can change, any view of the current performance of the euro ought to be taken over a rather longer time span than just six months. The ECB produce a trade weighted index series that links the ecu with the euro (the ecu ceased to exist when the euro began and was exchanged at a

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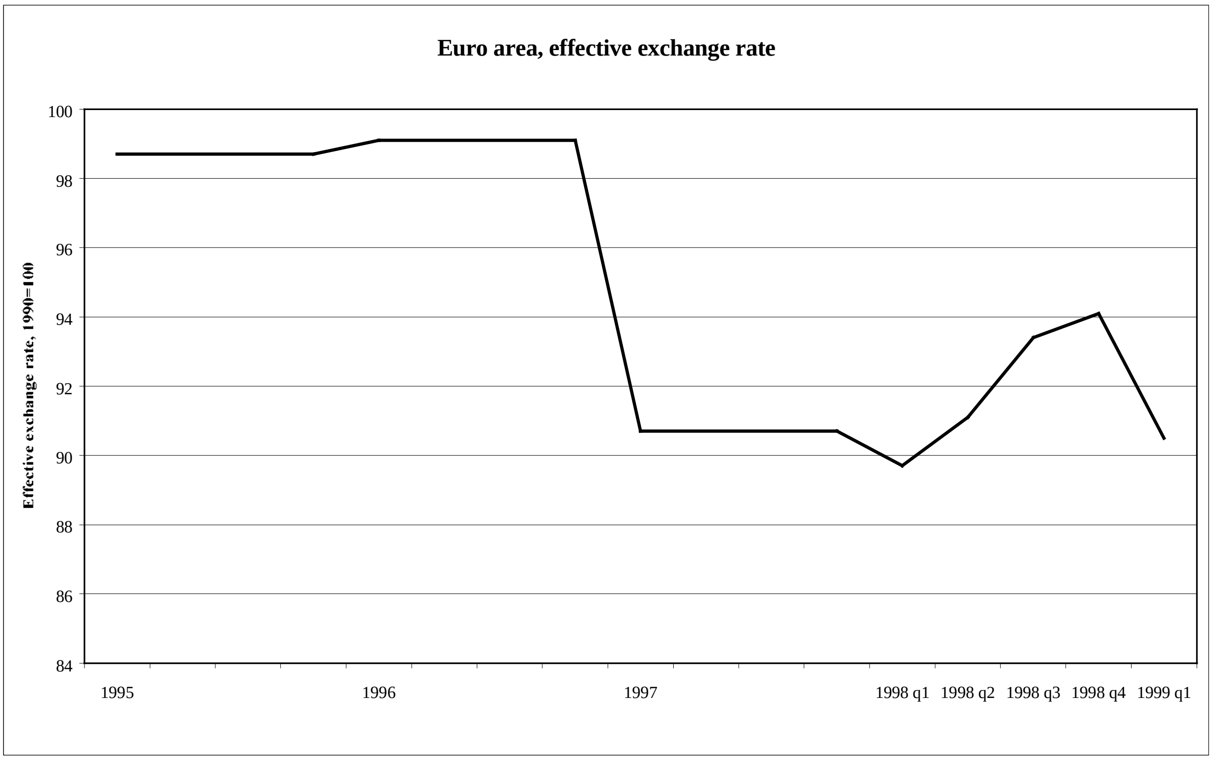
[24] ibid. January 1999

[25] ibid April 1999

rate of 1:1 on 1 January 1999). The value of the ecu/euro since 1995 is shown on the following page:[26]



Even if the longer-term view is taken of the euro it is clear that, however unfortunate it is now, from a longer time perspective the recent fall is no steeper or prolonged than previous declines. One major pressure on the euro is the relative economic position of the euro zone and America. Whereas the main drivers of the euro area economy – Germany and France are at, or near, the bottom of their economic cycle, implying that interest rates may have to fall further to revive them; in America the position is very different. The US economy continues to grow largely due to strong consumer demand. In response to indications of inflationary pressure the Federal Reserve has recently raised interest rates. Small wonder therefore that, right now, the dollar is a more attractive currency than the euro for international investors.

At a hearing at the European Parliament's Sub-Committee on Monetary Affairs on 19 April 1999 the President of the ECB, Dr. Willem F. Duisenberg, gave evidence following publication of the ECB’s first Annual Report. During the session he was asked:

> Mr Cassidy: I was interested in what the President of the ECB had to say in his analysis of the reasons for the weakness of the euro against the US dollar which

26 ibid, data derived from BIS and ECB calculations. Index based on weights of manufactured goods trade with main trading partners and consumer price indices

> he identified as the strength of the US economy. Could I ask him ….How does he explain the fact that the pound sterling, a traditionally weak currency, is currently strong against the euro?
>
> Mr Duisenberg: May I make a general remark about the rate of the euro, vis-à-vis the dollar? Some of my colleagues almost cannot help laughing when already after three weeks it was reported that the euro had reached historically low levels. Yet still the comparison that one makes normally is, naturally maybe, to compare the current rate of the euro with the one on 4 January when we started and when it was 1.16. It has not stayed there very long and what it actually has done is that it has, over a rather short period of time, reverted to its previous level. If you calculate what we call the synthetic euro, the euro "before it existed", the level where it had stood over the period of July 1997 until September 1998, that was a level of 1.08-1.10. Since then it has declined somewhat further. We do believe also today that it has to do with the increased uncertainty and anxiety over the crisis in Kosovo and that this has had a depressing impact on the rate of the euro.
>
> How to explain then that sterling has remained so strong? I don't have the full explanation, but one explanation I could point to is that interest rates in "Euroland" are significantly lower than interest rates in the UK, and that's a purely economic argument. It also explains of course, in part, the relative strength of the US dollar, vis-à-vis the euro, as interest rates are also significantly higher in the US than in Europe.[27]

In a subsequent comment the ECB accepted that internal euro-zone developments had also contributed to the weakness of the euro:

> The weakening of the euro against the US dollar…was mainly driven by economic developments [see above] but political developments also contributed.
> …
> The political news adversely affecting the euro included the continuation of the Kosovo military conflict and the decision by the European Ministers of Finance to grant Italy a higher budget deficit target than originally envisaged in its stability programme. The latter was interpreted by the markets as a potential general weakening of the commitment of the euro area Member States to reach the objectives of the Stability and Growth pact.[28]

The euro continued to decline steeply against the dollar throughout June and by early July the market expectation was that there would soon be parity between the dollar and the euro: a decline of 15% in its value since it came into existence.[29]

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[27] Hearing at the European Parliament's Sub-Committee on Monetary Affairs, Brussels on 19 April 1999

[28] ECB Monthly Bulletin, June 1999, p 39

[29] Although subsequent to the period covered by this Paper it should be noted that at the time of writing the euro was showing signs of a vigorous recovery, especially against sterling, but also against the dollar too.

C. Inflation

Low and stable levels of inflation are the bedrock upon which most of the economic advantages of EMU are based. Consequently, the success of the ECB to deliver on its constitutional imperative is crucial to the credibility of both the institution and the whole EMU project.

In its inaugural Annual Report the ECB declared that:

> The primary objective of monetary policy, namely price stability, is defined as a year on year increase in the HICP[30] for the euro-area of below 2%.[31]

One key feature of this policy is the asymmetrical nature of the policy target. In comparison with the Monetary Policy Committee's [MPC] remit in the UK which has to maintain inflation within a ±1% band around a target level of 2½% annual change in prices[32], the ECB just have to keep inflation below a target level (2%).[33] Inflation in the months prior to Stage 3 and since are shown in the table below:

Harmonized Indices of Consumer Prices[a]
EU 11

	1998		1999				
	Nov	Dec	Jan	Feb	Mar	Apr	May
% Change on prev' month	0.0	0.1	-0.1	0.3	0.3	0.3	0.0
% Change on prev' year	0.8	0.8	0.8	0.8	1.0	1.1	0.9

Note:[a] Prices (all items) not seasonally adjusted

Source:Eurostat

Clearly inflation in the euro zone is very low, reflecting the depressed state of the main economies within the area. Under the terms of its remit the MPC is required to reflate monetary conditions if the annual inflation rate falls below 1½%. By contrast the ECB is under no such compulsion and has decided not to reduce interest rates at its May meeting. It could be argued that the EMU constitutional structure imposes a deflationary bias on monetary policy-making within the euro-zone.

30 Harmonised consumer price index
31 ECB Annual Report 1998, page 8
32 Defined as the change in the RPI(X) index
33 Whether or not the ECB interpret this remit in quite this way is discussed in further detail in the section on the ECB.

D. Convergence

In the period preceding the start of Stage 3 of EMU the main focus of aspirant members' economic policy was to meet the convergence criteria as laid down in the Maastricht Treaty. The criteria, covering monetary conditions and government financial conditions, was designed to ensure that the countries that eventually participated in EMU had broadly similar economic conditions. It has been a contention of some commentators that the fact that the UK is not economically convergent with the rest of Europe is a key reason for resisting euro entry at present.

Economic convergence, in particular the convergence of monetary variables, on the part of euro-zone members is important if the monetary policy put forward by the ECB is to be broadly suitable for all members. The table below indicates the current degree of convergence between member states in terms of inflation and unemployment.

Euro zone convergence

	Unemployment[a]	Inflation[b]
		Ann'% ch'ge
	(April 1999)	*(May 1999)*
Belgium	9.0%	0.9%
Germany	9.1%	0.4%
Spain	17.3%	3.6%
France	11.3%	0.5%
Ireland	6.8%	2.3%
Italy	na	1.7%
Luxembourg	2.9%	0.6%
Netherlands	3.4%	1.8%
Austria	4.5%	0.3%
Portugal	4.3%	2.5%
Finland	10.6%	1.0%

Notes: [a] ILO Unemployed
[b]: Harmonised index of consumer prices

Source: Eurostat Statistics in focus
Eurostat Press Release

The two measures of economic convergence chosen, the unemployment rate and the rate of inflation, are both reasonable indicators of the state of the economy in the respective country. Their choice also makes it possible to address the important question about the 'one size fits all' nature of monetary policy making by the ECB. Are the countries within the euro-zone more or less converged than the regions of the United Kingdom? The first table (below) looks at the evidence from the unemployment data.

Labour Market Convergence

ILO Unemployment rate %

	UK	Euro-zone
Luxembourg		*2.9%*
Netherlands		*3.4%*
S. East (excl G. London)	3.8%	
Portugal		*4.3%*
Austria		*4.5%*
East of England	4.5%	
South West	4.8%	
East Midlands	5.1%	
North West	5.7%	
North West	5.7%	
West Midlands	6.7%	
Ireland		*6.8%*
Yorkshire & Humber	7.1%	
Scotland	7.2%	
London	7.6%	
Wales	7.8%	
N.Ireland	8.3%	
Belgium		*9.0%*
Germany		*9.1%*
North East	9.9%	
Finland		*10.6%*
France		*11.3%*
Italy		*12.0%*
Merseyside	11.6%	
Spain		*17.3%*

Source: Eurostat & ONS Labour Force Survey

Although the data, which are ranked in ascending order of unemployment, are not entirely comparable, for example they cover slightly different periods,[34]what is of interest is the range of rates rather than their absolute values. Two member states, Luxembourg and the Netherlands, had unemployment rates below those in the South East of England. Another two, Portugal and Austria have rates that are around the level of what could be described as the prosperous Southeast. Apart from Ireland, which is in the centre of the range, the remaining euro-zone participants dominate the upper scale of unemployment rates. Belgium and Germany have rates above that of N. Ireland and Finland and France are above the rates in the N East. Finally, Spain, has the highest unemployment rate, almost fifty per cent higher than the rate in Merseyside. Prima facie, therefore, the UK would appear to be a more cohesive ‘monetary union’ than the new euro zone.

The other measure of convergence is the rate of inflation. This is an important test for both the ECB and the UK’s Monetary Policy Committee since both have to meet an

[34] . The UK data comes from the winter 1998/9 Labour Force Survey whereas the euro-zone numbers relate to April 1999.

inflation target that is essentially an average of the inflation rates for the regions within their jurisdiction. Unfortunately data comparability is not as good as for the unemployment comparison. Official statistics for regional inflation rates are not published, however, an organisation – the *Reward Group* – does collate data on the regional cost of living and pay. They assess the cost of the same basket of goods bought in different regions of the country. From this it is possible to derive a regional inflation rate. For ease of comparison the inflation rates are expressed in terms of the percentage point difference from the area average for the euro-zone and the UK respectively. The results are shown below:

Inflation Rate Convergence

Percentage point difference from area average

	UK	Euro-zone
West Midlands	-1.9%	
Scotland	-1.3%	
Germany		*-1.3%*
France		*-1.1%*
Austria		*-1.1%*
East Midlands	-0.9%	
Luxembourg		*-0.8%*
North	-0.7%	
Wales	-0.5%	
Finland		*-0.5%*
Yorkshire & Humber	-0.4%	
South West	-0.4%	
Greater London	-0.4%	
Belgium		*-0.4%*
North West	-0.1%	
East Anglia	0.0%	
Italy		*0.0%*
Netherlands		*0.6%*
Ireland		*0.9%*
Portugal		*1.3%*
N.Ireland	1.5%	
Spain		*2.1%*
South East (excl G. London)	5.6%	

Sources: Eurostat Statistics in Focus
Reward Group, Cost of Living Survey

Again the data appear to indicate that the UK's regional inflation rates are indeed more homogenous than their European comparators. Only the South East of England stands out as being significantly different from the national average and this reflects the undue weighting given to housing cocsts in the *Reward* index. By contrast inflation in Spain is more than three percentage points higher than in other Member States.

Taken together therefore, these two indicators suggest that a single monetary policy does indeed fit less well in EMU than it does in the UK.

IV The European Central Bank [ECB]

A. Introduction

Since the ECB is the key institution at the heart of EMU the following section sets out its constitution, role and powers in some detail. It describes the role of the predecessor organisation to the ECB and also lists the various publications produced by it, some of which are readily available for reference in the Library or via the ECB's website (see below).

B. The EMI and the birth of the ECB

The immediate predecessor to the ECB was the European Monetary Institute (EMI).

This came into being on 1 January 1994 and marked the start of the second stage of EMU. The EMI's transitory existence also mirrored the state of monetary integration within the Community. The EMI had no responsibility for the conduct of monetary policy in the European Union - this remained the preserve of the national authorities - nor had it any competence for carrying out foreign exchange intervention. The two main tasks of the EMI were:

- to strengthen central bank co-operation and monetary policy co-ordination;

- to make the preparations required for the establishment of the European System of Central Banks (ESCB), for the conduct of the single monetary policy and for the creation of a single currency in the third stage.

The EMI provided a forum for consultation and for exchanges of views and information on policy issues and it specified the regulatory, organisational and logistical framework necessary to enable the ESCB to be able to 'hit the ground running' from January 1 1999.

With the establishment of the ECB on 1 June 1998 the EMI completed its tasks and was officially wound up.

C. The ECB

1. Objective and Role

The ECB is the central body of a broader organisational structure: the European System of Central Banks [ESCB]. The ESCB also includes the national central banks (NCBs) of all EU Member States. However, the NCBs of the Member States that do not participate in the euro area, are members of the ESCB with a special status. While they are allowed to conduct their respective national monetary policies, they do not take part in the decision-making regarding the single monetary policy for the euro area and the implementation of such decisions.

The governing legislation of the ESCB is set out in the Amsterdam Treaty (previously the Maastricht Treaty) as amended or supplemented by subsequent regulations. The primary objective of the ESCB is set out in Article 105 of the Treaty.

> The primary objective of the ESCB shall be to maintain price stability. Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Community with a view to contributing to the achievement of the objectives of the Community as laid down in Article 2 [promotion of harmonious, balanced and sustainable development of economic activities][35]

To this end the Treaty outlines basic tasks to be carried out by the ESCB. These are:

- to define and implement the monetary policy of the Community;
- to conduct foreign exchange operations;
- to hold and manage the official foreign reserves of the Member States; and
- to promote the smooth operation of payment systems.

In addition, the ESCB contributes to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system, while it also has an advisory role vis-à-vis the Community and national authorities on matters which fall within its field of competence, particularly where Community or national legislation is concerned. Finally, in order to undertake the tasks of the ESCB, the ECB, assisted by the NCBs, shall collect the necessary statistical information either from national authorities or directly from economic agents.

The ESCB is an independent system. When performing ESCB-related tasks, neither the ECB, nor an NCB, nor any member of their decision-making bodies may seek or take instructions from any external body. The Community institutions and bodies and the governments of the Member States may not seek to influence the members of the decision-making bodies of the ECB or of the NCBs in the performance of their tasks. The ESCB Statute makes provision for the following measures to ensure security of tenure for NCB governors and members of the Executive Board:

- a minimum renewable term of office for governors of five years;

35 Article 105, Treaty of Amsterdam, Cm 3780

- a minimum non-renewable term of office for members of the Executive Board of eight years (it should be noted that a system of staggered appointments is foreseen for the first Executive Board for members other than the President in order to ensure continuity);

- removal from office is only possible in the event of incapacity or serious misconduct; and

- the European Court of Justice is competent to settle any disputes.

2. Organisation

The work of the ESCB is carried out by three main decision-making bodies: the Governing Council, the Executive Board and the General Council. These are described below.

a. The Governing Council

> Article 10.1 of the Statute of the European System of Central Banks and of the European Central Bank: "In accordance with Article 109a (1) of this Treaty, the Governing Council shall comprise the members of the Executive Board of the ECB and the governors of the national central banks.

The Governing Council comprises all the members of the Executive Board and the governors of the NCBs of the participating Member States The main responsibilities of the Governing Council are:

- to adopt the guidelines and make the decisions necessary to ensure the performance of the tasks entrusted to the ESCB; and

- to formulate the monetary policy of the Community, including, as appropriate, decisions relating to intermediate monetary objectives, key interest rates and the supply of reserves in the ESCB, and to establish the necessary guidelines for their implementation.

b. The Executive Board

> Article 11.1 of the Statute of the European System of Central Banks and of the European Central Bank: "In accordance with Article 109a (2)(a) of this Treaty, the Executive Board shall comprise the President, the Vice-President and four other members."

The Executive Board comprises the President, the Vice-President and four other members, all chosen from among persons of recognised standing and professional experience in monetary or banking matters. They are appointed by common accord of the governments of the Member States at the level of the Heads of State or Government, on a recommendation from the European Council after it has consulted the European Parliament and the Governing Council of the ECB (i.e. the Council of the European Monetary Institute for the first appointments). The main responsibilities of the Executive Board are:

- to implement monetary policy in accordance with the guidelines and decisions laid down by the Governing Council of the ECB and, in doing so, to give the necessary instructions to the NCBs; and

- to execute those powers which have been delegated to it by the Governing Council of the ECB.

c. The General Council of the ECB

> Article 45.2 of the Statute of the European System of Central Banks and of the European Central Bank: "The General Council shall comprise the President and Vice-President of the ECB and the governors of the national central banks. The other members of the Executive Board may participate, without having the right to vote, in meetings of the General Council."

The General Council comprises the President and the Vice-President and the governors of all the NCBs, i.e. of all EU Member States. The General Council performs the tasks that the ECB took over from the European Monetary Institute (EMI) and which, owing to the derogation of one or more Member States, still have to be performed in the third stage. The General Council also contributes to:

- the ESCB's advisory functions (see above);

- the collection of statistical information;

- the preparation of the ECB's quarterly and annual reports and weekly consolidated financial statements;

- the establishment of the necessary rules for standardising the accounting and reporting of operations undertaken by the NCBs;

- the taking of measures relating to the establishment of the key for the ECB's capital subscription other than those already laid down in the Treaty;

- the laying-down of the conditions of employment of the ECB's staff; and

- the necessary preparations for irrevocably fixing the exchange rates of the currencies of the Member States with a derogation against the euro.

3. Ownership of the ECB

The ECB is wholly owned by the NCB's of EMU participating Member States. Its capital was established in the Treaty at €5 billion. However, since not all EU Member States have participated in EMU the initial share capital has been established at slightly under €4 billion. Each member state's share is determined according to a weighting composed of:

- 50% of the share of its respective member state in the gross domestic product at market prices of the community as recorded in the last five years preceding the penultimate year before the establishment of the ESCB
- 50% of the share of its respective member state in the population of the community in the penultimate year preceding the establishment of the ESCB

Germany has the largest shareholding (24.4%) according to this formula . The other main contributors are France (16.8%) and Italy (14.9%). Luxembourg is the smallest partner with a share of just 0.14%. If the UK were to join its shareholding would be 14.7%.

4. Monetary Policy

As was mentioned above the primary objective of the ESCB is to maintain price stability. The Governing Council interpreted this to mean:

> Price stability shall be defined as a year on year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of below 2%. Price stability according to this definition is to be maintained over the medium term.[36]

There has been some concern that this target embodies a deflationary bias to policy –this definition excludes the possibility of too low an inflation rate. However, this is refuted by the ECB. They comment that:

> The phrase below 2% clearly delineates the upper bound for the rate of measured inflation in the HICP which is consistent with price stability. At the same time, the use of the word "increase" in the definition clearly signals that deflation, i.e. Prolonged declines in the level of the HICP index, would not be deemed consistent with price stability.[37]

Monetary policy within the euro area is described as having 'two pillars'.

The first is the 'prominent role that is assigned to money'.[38] By this the ECB mean the explicit inflation target of 2% that they have set. It could be contrasted with alternative

[36] ECB monthly Bulletin January 1999, p 46
[37] op cit p 46
[38] op cit p 47

inflation strategies that might have targeted intermediate indicators of inflation such as the money supply as the main monetary target. In fact monetary targeting is not excluded from policy formation entirely.

The second pillar of monetary policy is a reference rate for the growth of M3 of 4½%. The influence of this rate is described thus:

> The reference value will help to inform and present interest rate decisions aimed at maintaining price stability over the medium term. Therefore, in the first instance, a deviation of monetary growth from the reference value will prompt further analysis to identify and interpret the economic disturbance…The relationship between actual monetary growth and the reference value will therefore be regularly and thoroughly analysed by the Governing Council.[39]

Other indicators of that will be assessed by the Council as they affect price developments include wages, the exchange rate, bond prices and the yield curve.

5. ECB Publications

The two most important publications are the *Monthly Bulletin* and the *Annual Report*. Of these the first is the most regularly useful. The first edition came out in January 1999 and the format includes a description of economic developments within the euro area, monetary conditions within the area and a substantial statistical appendix. Its parentage will be immediately familiar to regular readers of the Bundesbank monthly report. The Annual Report includes much of the same material, although with a different time perspective. It also describes the work of the ESCB and includes its accounts. The first edition of the Annual Report (1998) has already been published and includes developments and data up to March 1999.

The ECB have also commissioned a number of working papers that will in time form a series similar to that produced by the Bank of England and Treasury. Currently, five papers have been published, covering such topics as convergence, the effectiveness of fiscal policy and core inflation. Lastly, a good deal of information about the ECB and the euro zone can be gained from the ECB's website at http://www.ECB.int/.

V Openness and Transparency in the ECB

Some time before EMU came into operation on 1 January 1999 the debate on the working methods of the ECB and on the perceived development of a cult of secrecy by the Bank

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[39] op cit p 49

was gathering steam among politicians, economists, academics and bankers in the Member States. The main areas of concern were the Bank's lack of accountability to the Member States and the EU institutions and its lack of transparency. The latter issue was fuelled by the refusal of the President-designate and later President, Wim Duisenberg, to publish details of the Bank's inflation forecast and full minutes of its monetary policy meetings, including the voting records of individual Council members.

A. Requirements of the Treaty on European Union (TEU)

The independence of the ECB from other EU institutions and from the Member States is set out in Article 107 of the TEU (Amsterdam Article108), which states:

> When exercising the powers and carrying out the tasks and duties conferred upon them by this Treaty and the Statute of the ESCB, neither the ECB, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Community institutions or bodies, from any government of a Member State of from any other body. The Community institutions and bodies and the governments of the Member States undertake to respect this principle and not to seek to influence the member of the decision-making bodies of the ECB or of the national central banks in the performance of their tasks.

The main decision-making body in the European Central Bank is the Governing Council, made up of the executive board and the governors of the eleven national central banks in the 'euro zone'. Under Article 10.4 of Protocol 3 of the TEU *On the Statute of the European System of Central Banks and of the European Central Bank*, the proceedings of the meetings of the Governing Council "shall be confidential. The Governing Council may decide to make the outcome of its deliberations public".

The TEU requires in Article 109b (Amsterdam Article 113.3) that the ECB should publish annual and quarterly reports:

> on the activities of the ESCB and on the monetary policy of both the previous and current year to the European Parliament, the Council and the Commission, and also to the European Council. The President of the ECB shall present this report to the Council and to the European Parliament, which may hold a general debate on that basis.

Members of the ECB's executive board may also have to appear before European Parliament committee hearings (TEU 109b, Amsterdam 113.3).

There is no public access to ECB documents, although under Article 15.4 of the *Statute* annual and quarterly reports of the ECB and a weekly consolidated financial statement of the ESCB "shall be made available to interested parties free of charge".

B. Rules of Procedure of the ECB and of the General Council of the ECB

Article 23 of the ECB *Rules of Procedure* on *Confidentiality of and access to ECB documents and archives* states:

> 23.1 The proceedings of the decision-making bodies of the ECB and of any committee or group established by them shall be confidential unless the Governing Council authorises the President to make the outcome of their deliberations public.
>
> 23.2 All documents drawn up by the ECB shall be confidential unless the Governing Council decides otherwise. Access to ECB documentation and archives and to documents previously held in the archives of the EMI shall be governed by the Decision of the European Central Bank of 3 November 1998 concerning public access to documentation and the archives of the European Central Bank (ECB/1998/12).
>
> 23.3 Documents held in the archives of the Committee of Governors of the Central Banks of the Member States of the European Economic Community, of the EMI and of the ECB shall be freely accessible after thirty years. In special cases the Governing Council may shorten this period.[40]

Article 8 of the Rules of Procedure of the General Council of the ECB on *Confidentiality of and access to ECB documents and archives* states:

> 8.1 The proceedings of the General Council, and of any committee or group dealing with matters falling within its competence, shall be confidential unless the General Council authorises the President to make the outcome of their deliberations public.
>
> 8.2 All documents drawn up by the General Council, and by any committee or group dealing with matters falling within its competence, shall be confidential unless the General Council decides otherwise. Such documents shall form an integral part of the documentation in the ECB archives and shall be accessible according to the same criteria as shall be specified by the Governing Council for access to the ECB archives.[41]

[40] Rules of Procedure of the European Central Bank, as amended on 22 April 1999, http://www.ecb.int/index.html.
[41] 1 September 1998, http://www.ecb.int/index.html

C. The Democratic Deficit

This expression has frequently been used to describe the perception that EC legislation, which occupies an increasing proportion of national law in the Member States, and once adopted is not reversible by a single country, is not subject to the judgement of the electorate or their elected representatives in the same way as national legislation. The EP, the EU's only directly elected body, has benefited from moves to remedy this situation and has gradually gained new powers and more influence in a wider range of areas from the mid-1980s. Reforms in granting access to documentation have gradually endowed the Commission and Council with a greater degree of democratic legitimacy, although the credibility of the Commission was somewhat damaged by the report in March 1999 into fraud and corruption among Commissioners and their staff. The Commission has yet to implement new measures proposed by the President-designate, Romano Prodi, in the wake of the report.

The ECB, will, as one author has put it, set " a precedent for European co-operation without national representation".[42] The national governments and the EU institutions have given to the ECB the power and the obligation to set monetary policy in the interests of the euro-zone as a whole. Although the establishment of the ECB, and the whole single currency project, have been the work of politicians, it is independent of formal political influence and national interests. What is more, its decisions are not, according to the Treaty and its own internal rules, to be made fully and readily available to the Member States or the EU institutions. The euro-zone states have surrendered a significant aspect of national competence to an EU creation independent of political pressures and national sensitivities. The *Economist* comments in a report on EMU and the ECB:

> On the face of it, there is a loss to democracy as well as a loss of sovereignty at stake here. National governments, and their citizens, are surrendering powers of self-determination that governments and citizens of the future are not meant to recover. The presumption in the benign view of EMU must be that the loss to democracy and self-determination will be offset by a gain in those commodities at the European level.[43]

Other commentators see the ECB as the beginning of an inevitable search for supranational institutions which will in time acquire their own democratic legitimacy.

ECB provisions lack other democratic safeguards guaranteed by the constitutions and statutes of national central banks: neither the EC Treaty nor the Bank's Statute provides for members of the ECB Governing Council to be removed from office by the EU institutions (eg. the EP, Council of Ministers or Court of Justice). An editorial in the *Times* commented:

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[42] Matt Marshall, *The Bank: the birth of Europe's Central Bank and the rebirth of Europe's power*, 1999, quoted in *Financial Times*, 15 June 1999.

[43] *Economist*, 5 December 1998.

> Neither elected politicians nor judges can launch any action against central bankers, even in cases of gross incompetence or corruption. An institution with such absolute immunity from outside monitoring must be expected, even more surely than the Commission, to succumb to the corrupting influence of absolute unaccountable power.[44]

Other issues surrounding the ECB include the following:

- How can the Bank's independence be balanced with its democratic accountability?
- What effect might secrecy or openness have on the stability of the euro?
- Should transparency apply just to ECB policy or to the whole policy process?
- How will monetary policy be separated from political the political arena?
- How will citizens be able to trust the ECB to take decisions which may be unpopular in the short-term in the knowledge that their long-term interests will be taken care of?

1. Independence

In spite of the ECB's independence, like national central banks it does not operate in a political vacuum, and the political contexts in which the Bank was conceived and now operates are, as one commentator has put it, 'all-pervasive'.[45] The argument has been made that since the TEU was negotiated in 1991, most EU governments, including the two main protagonists, the French and German governments, have moved to the left (only Ireland and Spain are now governed by conservatives). It has been suggested that, had the TEU been negotiated by the centre-left instead of the centre-right, more ECB accountability might have been written into the Treaty.[46] Politicians have already made public their views on the wisdom of ECB decisions. Before he stood down in March 1999, the controversial new German finance minister, Oskar Lafontaine, had spoken out on interest rates and unemployment. He was joined by the French finance minister, Dominique Strauss-Kahn.

> The EU's heavy political agenda and its commitment to reducing unemployment will inevitably influence ECB monetary policy: the question is the extent to which political intervention might compromise ECB independence. The ECB's first monthly report indicated that the ECB was taking the political agenda of the EU into account. It referred explicitly to the "broad need for mutual co-operation and dialogue among policy-makers in an interdependent environment".[47] The report also emphasised its concern for the high level of unemployment in the euro zone.

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[44] 29 March 1999.
[45] Tony Barber, *Irish Times*, 27 January 1999.
[46] See Irish Times, 27 November 1998.
[47] *ECB Monthly Bulletin*, January 1999, p 41.

2. Accountability

The Treasury Select Committee concluded in a report on the *Accountability of the Bank of England* that "Accountability is an elusive concept and trying to find an accurate and comprehensive definition is correspondingly difficult".[48] Other commentators have ventured to define the concept. In a section on accountability in central banks, Rosa María Lastra notes:

> Accountability requires that the central bank, at the very least, explain and justify its policies or actions, and give account for the decisions made in the execution of its responsibilities. An independent central bank needs to be accountable to another authority. This authority may be executive, legislative or judicial … .[49]

Accountability should be:

> … dispersed through the three branches of the state, through institutions with differing obligations to the electorate to provide the democratic legitimacy that an independent central bank would otherwise lack.[50]

Lastra also emphasises the importance of public support for the long-term sustainability of a central bank, the need for information on the operation of monetary policy to be disclosed and for performance to be measurable:

> Performance is generally measured with relation to the statutory goal/s to be achieved. The governing bodies of the central bank, particularly the governor, should be held accountable for failing to achieve such objectives.[51]

In a book on central banks Marjorie Deane and Robert Pringle emphasise the importance of the individuals who run central banks:

> Accountability is a matter of individual responsibility. … Confidence in a central bank depends almost indecently on the reputation of the few at the top who are allowed public faces.[52]

Deane and Pringle also emphasise the need to explain central bank behaviour to the "man in the street". The successful central banker must be able to "communicate with a conscious regard for the interests of the community".[53] It is probably too early to say

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48 Treasury Select Committee, *Accountability of the Bank of England*, 23 October 1997, HC 282 1997-98, p vi para 7. See also House of Commons Library Research Paper 98/78, *EMU: the constitutional implications*, 27 July 1998, pp. 12-20.
49 Rosa María Lastra, *Central Banking and Banking Regulation*, 1996, p.49.
50 Lastra, ibid.
51 Lastra, p.50.
52 Marjorie Deane and Robert Pringle, *The Central Banks*, 1994, p.12.
53 Deane and Pringle, p.313.

whether the ECB has communicated its policy successfully to the "man in the street". The European polling organisation *Eurobarometer* conducted several polls on public confidence in the euro prior to its introduction,[54] but not yet on the extent to which the public trusts or understands the policies or methods of the ECB since it has come into existence. *Europinion*, published by the European Commission, conducted a survey of public opinion on various aspects of the single currency in 1998, including views on the ECB, its independence and accountability. On support for the ECB generally the survey concluded:

> In all the Member States, more than 50% of the public support the existence of the European Central Bank. Support levels are highest in The Netherlands (84%) and lowest in Portugal (53%), where more than 30% of people still lack an opinion on this issue.[55] At 25% and 23%, respectively, opposition levels are highest in Denmark and the UK. (Table 3.7) People who support the European Central Bank are significantly more likely to support the euro (68%) than people who do not support its existence (42%).[56]

The *Europinion* survey concluded:

> Although in some countries a substantial proportion of the population still lacks an opinion, it is clear that the public leans in favour of democratic control of Europe's economic and monetary policy.[57]

On the subject of accountability and transparency, the ECB's first monthly report was adamant that the Bank had fulfilled all the necessary requirements:

> All central banks operate in a certain social, political and institutional environment. In a democratic context, it is vital that an independent central bank is open, transparent and clear about the reasoning for its actions, and accountable for its performance. Recognising the importance of these issues in the euro area, the Treaty imposes on the Eurosystem some of the most stringent reporting obligations required of any central bank. In practice, the Eurosystem has already committed itself to exceeding even these stringent requirements (see Box 3: Transparency and accountability of the Eurosystem).
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> Box 3 Transparency and accountability of the Eurosystem

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[54] See *Eurobarometer 50*, March 1999 (fieldwork October-November 1998) and *Eurobarometer 49* (fieldwork April-May 1998).

[55] The survey also noted that: "In many other countries, the proportion of 'don't know' responses is also quite high. Since the ECB did not yet start its activities at the time of the survey, this finding is not at all surprising".

[56] European Commission, DG X/A2, "European Public Opinion on the Single Currency", *Europinion Special Edition*, January 1999. Tables showing opinions on ECB independence and accountability can be found in the section on *Views on the ECB*.

[57] *Ibid*.

> In general, central banks should be open, transparent and accountable, reporting fully to the public on their activities, including their conduct of monetary policy. A transparent and accountable central bank reinforces its credibility by communicating clearly with the public and thereby signalling that its monetary policy is appropriately oriented to the maintenance of price stability. In this regard, the Eurosystem meets or exceeds the best practices of any central bank. The President of the ECB will hold a press conference immediately after the first Governing Council meeting of every month. On these occasions, the President will present an extensive statement of the Council's view of the economic situation and the outlook for price developments, followed by a question and answer session. The schedule for these meetings and conferences has already been announced for 1999. This regular statement will be supplemented by the publication of a Monthly Bulletin. The Monthly Bulletin is intended to provide the general public and financial markets with a thorough assessment of the economic environment, as well as with articles about the economy's structure and topical issues important for the single monetary policy. Furthermore, the Eurosystem's balance sheet will be published weekly. An annual report on the activities of the Eurosystem must be produced, supplemented by the production of quarterly reports. These reports are to be submitted to the European Parliament, the Council of Ministers and the Commission of the European Communities. The European Parliament will hold a general debate on the reports that it receives. The ECB President and Executive Board members have to answer questions posed by the European Parliament's committees. The President will appear before the parliamentary committee five times each year, following the submission of the quarterly and annual reports mentioned above. In speeches, members of the Governing Council will also inform the public about monetary policy and the economy. Working papers and technical analysis by ECB staff will be published for professional review and scientific assessment. These articles and other presentations will address not only the central issue of monetary policy and the monetary transmission mechanism, but also the major economic problems facing Europe, not least the problem of the high level of unemployment. Through all these media, the ECB is committed to communicating with the public in a clear and transparent manner. Against this background, the Eurosystem clearly demonstrates high levels of transparency and accountability.[58]

3. Access to information

Broad differences have emerged in the approach to central bank independence and accountability between continental Europe and the Anglo-Saxon economies. In most continental European countries central banks do not publish the minutes of governors' meetings, for example, whereas in the UK and the US they do. It has been argued that the ECB should seek greater political legitimacy and credibility by:

- publishing inflation forecasts and targets with the reasoning behind them;
- publishing summaries of discussions in the Governing Council;

[58] *ECB Monthly Bulletin*, January 1999, p. 42.

- publishing the voting records of individual Council members;
- granting the EP a stronger role by giving it the task of formally endorsing the Bank's inflation target, reporting annually on the Bank's performance and requiring the Bank to respond.

Robert Chote, writing in the *Financial Times*, considered that transparency was important, not only to legitimise the ECB's independence, but also because:

> Monetary policy will be more effective and less disruptive if financial market participants and other economic agents understand why the central bank is doing whatever it is doing. If the central bank takes the time to explain its thinking thoroughly, market reactions to policy should become more predictable.[59]

As President-designate of the ECB, Wim Duisenberg emphasised the need for the future Bank to be independent, open and accountable:

> Central bank independence has already proved to be a key institutional ingredient for achieving and maintaining price stability. However, I think that we would all agree that independence needs to be complemented by accountability. As a matter of principle, in a democratic society there is clearly no room for a lack of accountability in public institutions, and the ESCB, being an important public institution, must be accountable. In turn, accountability requires effective communication, since otherwise it would seem difficult, if not impossible, for any central bank to be held properly accountable. I am aware that it has sometimes been argued that there is a so-called "democratic deficit" in the current arrangements at an EU level; that the ESCB will be a powerful, but "unaccountable", institution. I disagree with this view. The ESCB cannot afford, any more than existing European central banks, to contemplate the conduct of monetary policy "in a vacuum". The ESCB has to be accountable, and this has to be underpinned by a high degree of transparency and an active communications policy.
>
> But apart from the democratic duty of the ESCB to be accountable, coherence and being communicative also serve other practical purposes. For instance, well constructed and well explained monetary policies can influence the expectations of private agents, such as trade unions and employers. Market expectations are of importance for the effectiveness of monetary policy measures and clear as well as transparent and predictable policies may enhance and facilitate the conduct of monetary policy. Let me give you an example. If the central bank is known to react to excessive wage demands by raising interest rates, thereby stabilising prices at the cost of a temporary reduction in output and employment, the excessive wage demands may not occur in the first place. Thus, if economic agents understand how the central bank will react, the need for monetary policy measures - and the consequences in terms of foregone output and employment - may be substantially reduced.

[59] 2 March 1998.

> In addition, coherent and well-explained monetary policies are also needed in order to enable the national authorities to conduct compatible policies. This applies, in particular, to the overall fiscal policy stance in the Monetary Union. Monetary and fiscal co-ordination may be difficult in an environment of unpredictable and poorly understood monetary policies.[60]

At the ECB Governing Council's first meeting on 9 June 1998 it was announced that summaries of their monthly meetings and regular economic reports would be published. On 15 July 1998 Mr Duisenberg agreed to the publication of reports of board meetings, including explanations of interest-rate decisions.[61] Full minutes showing how Governors had voted would not be published, however. Mr Duisenberg pledged to appear before the EP to be questioned about policy decisions but did not extend this to appearing before national parliaments.

Ottmar Issing, a German member of the ECB's Executive Board, defended the Bank's position on independence and accountability in an article in the *Financial Times* on 22 September 1998. After outlining the procedures put in place by the ECB, he continued:

> In a democracy, independence cannot be granted without a clear and limited mandate: for the ECB, it is to maintain price stability. This will be the benchmark against which its actions will be judged, It is in the ECB's interests to give an account of its monetary policy and to explain how it has contributed to that aim.

Mr Issing said that not publishing minutes did not mean a lack of accountability. He insisted furthermore that the decision not to publish them was not an ECB decision, but a requirement of the Maastricht Treaty, "a decision of politicians, not central bankers". He supported this position:

> What is essential for the effectiveness of the decision-making process is that the discussion within the ECB Governing Council on monetary policy is as frank as possible. This may not be the case if those involved feel they must be circumspect about the way in which their opinions are reflected in the minutes of the Governing Council and their potential impact on financial markets. Members must feel free to change their opinions in the course of the debate but once a decision is taken, they should publicly support it, even if they had voted against it. "Personalisation" of the internal debate can only be detrimental to the decision-making process and public perception. What is important is that the main arguments that have led the ECB to take a certain policy decision are explained to the public convincingly.[62]

60 "The ESCB: Independent, transparent and communicative" Speech delivered by Dr. Willem F. Duisenberg, President of the European Monetary Institute, at the Bankers' Club Annual Banquet in London, 16 February 1998.

61 He also disclosed his salary of around £160,000, which he had previously maintained was secret.

62 *Financial Times*, 22 September 1998.

While Mr Issing considered that the independence of the Bank could be put at risk if external pressures were put on members of the Governing Council as a result of publishing individual voting behaviour, Professor Willem Buiter, a member of the Monetary Committee of the Bank of England, argued, on the contrary, that secret voting "would put ECB independence at risk", that central bank independence "could not survive without openness and transparency".[63] He warned of the dangers of leaks and hints by "national political insiders" that could force members to yield to the pressures of national interests without having to justify their behaviour publicly. In Buiter's view the publication of individual votes would shield them from political pressure to vote in their national interests. He continued:

> Smoke-filled rooms and confidentiality are more likely to allow the ECB mandate and independence to be perverted by national political pressures than openness and the occasional short-term embarrassment that this entails.[64]

In a paper published by the Centre for Economics and Policy Research (CEPR) in April 1999, Professor Buiter proposed various reforms to improve transparency and accountability, including the publication of minutes, inflation forecasts and voting records. He also proposed that national governors should not automatically become members of the Governing Council and that the ECB should be "explicitly responsible for systematic financial stability in Euroland".[65]

A *Financial Times* editorial on 25 September concluded:

> Both sides have good arguments. The answer is that the ECB should aim for the ideal situation – where, with no publication of votes, the Governing Council would be free to act according to the interests of the whole euro-zone – but keep a keen eye out for Professor Buiter's concerns.

The publication of votes could be a reserve tactic to be applied if it appeared that Governors were taking advantage of their anonymity. The *FT* came down in favour of confidential votes as "the best bet for keeping politics out of the ECB".

ECB officials have argued that the publication of inflation forecasts could be counter-productive. An ECB prediction of rising inflation might become self-fulfilling, for example. One German critic suggested that trade unions, for example, "might treat a forecast of rising inflation as a pretext for a high wage demand".[66] The *Irish Times* reported the views of Christian Noyer, the French ECB Vice-President:

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63 *Financial Times*, 3 July 1998.
64 *Ibid*, letters.
65 *Independent*, 21 April 1999.
66 Wolfgang Münchau, *Financial Times*, 30 October 1998.

> For the ECB to publish the minutes of its council meetings would create a meaningless " false transparency" and everything of importance "would take place in the corridors". … He believes the ECB's summaries, produced within half an hour of meetings, are sufficient.[67]

At his April 1999 appearance before the EP's Monetary Committee Mr Duisenberg, by now four months in office, was adamant that he could do little more to improve communication and openness in the ECB:

> Well, I do not know how further to improve our communication. Admittedly any word chosen may give rise to misinterpretations and we try to avoid that as much as possible, but we also try to be as open as possible and as quickly as possible. On the day that we take the decision, I give a press conference and I give an introductory statement at that press conference which explains in detail the rationale behind the decisions that have been taken. The introductory statement is put on the Internet immediately, and after the press conference the transcript of the question and answer sessions is also added to it on the Internet. It is as open and as transparent as possible. Last week, if I might take it as an anecdote, a Member of the British Parliament said to me that he was a close follower of the monthly bulletin, of the transcripts of the press conferences and of the question and answer sessions during the press conferences, on the Internet and that he had come to the conclusion that the transparency and openness of the ECB compares rather favourably with that of the Monetary Policy Committee of the Bank of England.[68]

D. The Role of the European Parliament

Deane and Pringle comment on the roles of parliaments and governments in their relations with central banks:

> Debates about a central bank's accountability for monetary policy tend to revolve about how formal lines of answerability can be established and whether these should be to parliament or the executive. Though the answer may have to take constitutional frameworks into account, many feel that the public will be better served and the credibility of independence enhanced if a central bank reports directly to parliament, as the Federal Reserve does, and there are several ways by which such reporting can be formalized. However, we recognize that parliament may often be as big a threat to monetary stability as the government, since delegates want their pet projects financed.[69]

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[67] 17 February 1999.

[68] Committee on Economic and Monetary Affairs and Industrial Policy, Subcommittee on Monetary Affairs Hearing with Wim Duisenberg, Brussels, 19 April 1999.

[69] Marjorie Deane and Robert Pringle, *The Central Banks*, 1994, p.342.

The ECB will not be answerable to the EP in the same way that some national central banks are answerable to national parliaments, although the ECB will produce annual reports which will be addressed to the EP as well as to the European Council. The EP can also invite the ECB President to explain his policies, but it has sought a greater role in monitoring the Bank's performance. One of the problems facing the EP at the moment is its own relatively low level of public esteem, reflected in the record low turn-out in elections in June.[70] The Treaty could, of course, be amended by unanimous agreement of the Member States to grant the EP more powers of control in relation to the ECB, although it is by no means certain that there would be a consensus among the fifteen to do this.

1. ECB Appointments

Under the Treaty the EP has had a decisive role in the appointment of the ECB President and Executive Board. On 2 May 1998 the Council of Ministers consulted the EP on the nomination of Wim Duisenberg as the first President of the ECB for an 8-year term. The EP Committee on Economic Affairs evaluated Mr Duisenberg's credentials and received a statement and answers to a questionnaire from the Presidency candidate which were published in the EP's *Recommendation on the appointment of Dr W.F.Duisenberg as President of the European Central Bank*.[71] The EP conducted public hearings on the six prospective members of the ECB Executive Board, including Mr Duisenberg, on 7-8 May 1998 and approved the nominations.

2. Monitoring the ECB

The ECB must report to the EP on a regular basis, the President's report may be debated by the EP and hearings may be held by relevant EP committees. The Bank is not directly accountable to the EP, however. Deane and Pringle point to this as another feature of the ECB that makes it different from a national central bank:

> … the [European] Parliament would not have the ultimate sanction possessed by American and German legislatures, which is that they can amend the laws defining the duties and behaviour of their central banks, even abolish them altogether. The European statutes can be changed only by amendment to the Treaty, which requires ratification by every EC country …[72]

A report in the *Irish Times* commented:

> Accountability should not be confused with independence. The US Federal Reserve Board is one of the most independent of central banks, but its chairman,

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[70] Voter turnout was 49% in 1999, compared with an EU average of 57% in 1994, 59% in 1989, 61% in 1984 and 63% in 1979. See Library Research Paper 99/64, *Elections to the European Parliament-June 1999*, 21 June 1999.

[71] EP Report, A4-0182/98, 11 May 1998.

[72] Deane and Pringle, p.335.

> Mr Alan Greenspan, regularly appears before various arms of the US Congress publicly explaining policy and fielding questions. The ECB President, … , in contrast, will appear before the toothless European Parliament just four times a year and the real business will be done behind closed doors in meetings with EU finance ministers.[73]

3. EP/ECB links

The EP's internal structures for dialogue with the ECB were felt by many MEPs to be inadequate, and in November 1998 the British Socialist MEP, Ken Collins, put forward proposals to reform the EP's committee structure to provide better contacts with the Bank. The Economic and Monetary Affairs Subcommittee would be promoted to become a fully-fledged Monetary Policy and Banking Committee. However, the proposals were delayed by the EP elections in June and are not likely to be considered until autumn 1999.

4. Wim Duisenberg before the EP

Wim Duisenberg has appeared before the EP Monetary Committee on a number of occasions both before and since the advent of the euro on 1 January 1999 and has responded to criticism from the EP on the subject of ECB secrecy. He was critical of the US Federal Reserve's practice of publishing minutes of policy-making meetings after six weeks, and of the Bank of England's openness in January 1998 in publishing information on divisions in its Monetary Policy Committee. Attributing the subsequent overvaluation of sterling to this publicity, he told the European Parliament that the ECB should not publish the minutes of Council meetings for sixteen years. Seeking to clarify this point, he told the EP:

> I do not really care whether it is 16 years or 20 or 15 or even 10. What I care about is that it has to be so long that no national central bank governor who took part in a decision and the preparation of a decision is in office when the minutes including his or her contribution to the discussion are published. National central bank governors are also answerable and accountable to national parliaments. I and all my colleagues agree that we would want to avoid people being able to influence or meddle through the back door with the independence of the decision-making power of individual members of the board.[74]

Below is the exchange in the EP between the British Labour MEP, Alan Donnelly, and Mr Duisenberg on communication and openness

> **Donnelly, Alan (PSE)**. - Following on from Mrs Hautala's very important question about the publication of the minutes I should like to refer to something said by a fellow countryman of Mr Duisenberg, Willem Buiter. He said very recently in a European publication that if the ECB does not conduct its monetary

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[73] 27 November 1998.

[74] Hearing of Wim Duisenberg, EP Monetary Committee, 7-8 May 1999,

policy as openly as possible, he thinks there will be a huge accountability deficit right at the start of this new institution and that this would be an extremely grave error. He goes on to say that he is worried that the German/Dutch tradition of secrecy in central banking could hurt the legitimacy of the EMU enterprise.

Is it not complete nonsense that you are only going to publish the minutes sixteen years after these meetings have been held when the Bank of England and, indeed, the Federal Reserve Board are considerably more open? This in no way impinges upon the monetary policy or the legitimacy of the bank. Can we not have a new design for the European Union that will be based on trying to build public confidence for the citizens not surrounded by secrecy which is your tradition and the tradition in Germany?

Duisenberg. - Secrecy in the decision-making process can co-exist very well with being open and transparent and explicatory of the decisions once they have been taken. But it is the deliberations themselves which to my mind stand in the way of the wish to be as open as Mr Donnelly suggests. Publication of the minutes soon after decisions have been taken or meetings have taken place will - and this is human - make it more difficult for individual participants in the discussion to change their minds and to be convinced of the arguments of others.

Donnelly, Alan (PSE). - Can you give me an example?

Duisenberg. **-** I will be very frank with you. I find unhelpful the ongoing discussion in the United Kingdom since January of this year where the Monetary Policy Council was divided and where it was reported immediately that first it was 4 to 2, then it was 3 to 3 at the next month's meeting with the Governor casting the deciding vote. That undeniably had an impact on markets and it increased uncertainty. It enhanced speculation as to what would happen at the next meeting of the Monetary Council. So, it is not neutral. I have seen similar examples in the United States where the minutes of the meeting of the Federal Open Market Committee are published six weeks after the meeting. There have been one or two examples where market expectations have been influenced and before the next meeting markets anticipated or took a position which was based on the likely attitude to be taken by the members of the FOMC at their next meeting.

Donnelly, Alan (PSE). **-** I simply do not accept that. There is speculation in the press but no speculation in the markets. I do not find your answer acceptable. You have to try to build public confidence in the European Union for the new Central Bank and shrouding the Bank's decisions in secrecy for 16 years is not the way to build public confidence. Let me tell you that you are going to have to think again about this. When we as a parliament meet with you, we are going to have to explore this further. The Bundesbank has public confidence because traditionally since the end of the Second World War it has managed things appropriately. You are starting without that public confidence and citizens want to know the way in which these decisions are taken, not 16 years later but within a reasonable period. You are going to have to find a better way of informing us as a parliament and the public about the way in which you have taken your decisions.

> **Duisenberg. -** I disagree. The 16 years is not sacrosanct. I only said I would be very happy to publish the minutes at a moment in time where publishing the minutes would have no impact any more on market expectations whether through the press or other channels. They would have to have no impact. That is what determines the timescale of publication. You can only inspire confidence by your actions and by the success which your actions are having and by explaining them as fully as possible.[75]

In September 1998 Mr Duisenberg addressed the EP's Monetary Committee again. His views on this occasion were summarised as follows:

> On the democratic accountability of the ECB and its relations with Parliament, Mr Duisenberg said that he would appear before the House four times a year at least, but did not exclude the possibility of more meetings. He explained, however, that he had no intention of publishing the minutes of meetings of the Governing Council. Publishing minutes could lead to certain market expectations and that should be avoided. Furthermore, governments would then know the positions taken by members of the Bank and might put pressure on them. It would depend on the nature of documents whether or not these would be made available to MEPs.[76]

5. EP Ombudsman Enquiry

In an initiative launched in June 1996 the European Ombudsman, Jacob Söderman, had recommended that all Community institutions should adopt rules concerning public access to their documents:

> Good administration requires that all Community institutions and bodies should take into account the Union's commitment to transparency. This commitment appears from Declaration No 17 attached to the Final Act of the Treaty on European Union and from numerous subsequent acts including, in particular, the Interinstitutional Agreement on democracy, transparency and subsidiarity of 25 October 1993. Transparency requires not only that documents should be publicly available to the maximum extent possible, but also that any denial of access to documents should be justified by reference to rules laid down in advance.
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> Furthermore, Article C of the Treaty on European Union provides that "the Union is served by a single institutional framework which shall ensure the consistency and the continuity of the activities carried out in order to attain its objectives (...)". European citizens are therefore entitled to expect a consistent approach to the question of public access to documents. This does not necessarily require a single set of rules that applies to all Community institutions and bodies. However, it does exclude arbitrary differences as to whether or not rules exist and are made

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75 Hearing of Wim Duisenberg, President designate of the ECB, 7 - 8. 5. 1998, http://europa.eu.int
76 22 September 1998, Wim Duisenberg to EP Subcommittee on Monetary Affairs.

> publicly available. None of the Community institutions or bodies covered by the inquiry has presented evidence that the adoption of rules governing public access to documents would be impractical or unduly burdensome in its specific circumstances. The adoption of such rules is therefore an appropriate measure in relation to the processing of requests for documents.[77]

In the Special Report to the EP in December 1997 the Ombudsman reported that fourteen EU institutions had fulfilled the requirements of the recommendation, including the ECB's predecessor, the EMI.[78] In April 1999 Mr Söderman opened an own-initiative inquiry into ECB openness to which the ECB has yet to reply.

E. Views on the ECB

1. The Member States

The British Government's policy has been to prepare to join EMU but not to join until certain economic tests have been met and a referendum has been held. Despite this fact, the issues have been raised in parliamentary debates, questions and Select Committee enquiries[79]. In reply to a question on increasing democratic accountability and transparency in the ECB the Economic Secretary at the Treasury, Patricia Hewitt, replied:

> Article 109b(3) of the Maastricht Treaty contains several provisions designed to balance the necessary independence of the European Central Bank with the need for democratic accountability. The Government believe that accountability and transparency in policy-making will be key to ensuring that the European Central Bank gains the trust of the European public and financial markets. Ultimately, it will help to provide the credibility needed to deliver a more effective monetary policy.[80]

Didier Migaud, a Socialist Deputy in the *Assemblée Nationale* and rapporteur of the French Parliamentary Finance Commission, was critical of ECB Governors for agreeing a restrictive policy on accountability. He was concerned that this seemed to "go against the large consensus, especially evident during negotiation of the Treaty of Amsterdam, in favour of parliaments being more closely associated with Community procedures". He continued:

> The construction of Europe cannot go on long like this without encouraging the anti-Europeans and increasing misunderstandings.[81]

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77 Draft recommendation of the European Ombudsman on the own initiative inquiry into public access to documents (616/PUBAC/F/IJH), 20 December 1996.

78 616/PUBAC/F/IJH, 15 December 1997.

79 The most recent Treasury Select Committee Report on EMU is the fifth report, HC 503 of 1997/98 *The UK and preparations for stage three economic and monetary union* Government's response HC 905 1997/98 Treasury Select Committee sixth special report.

80 HC Deb, 16 march 1999, c 646W.

81 *Financial Times*, 18 June 1998.

The Germans on the whole approve of the working methods of the ECB, perhaps because of its perceived similarity to the *Bundesbank*.[82] Others have criticised it for the same reason. In November 1998 Oskar Lafontaine also called for greater ECB transparency.[83]

The Austrian Prime Minister, Victor Klima, in his capacity as President of the EU in the second half of 1998, called for the ECB to publish minutes of its meetings, telling the *Financial Times*:

> The independence of the Central Bank has to be guaranteed, but that does not mean there should not be a dialogue and transparency between independent partners.[84]

2. International Monetary Fund

On 23 April 1999, in its first review of the ECB's policies, the International Monetary Fund (IMF) contributed to the debate on openness in the Bank:

> Directors underlined that it was particularly important at the early stages of the ECB, in view of the uncertainties in the outlook for the euro area and the global economy, that the public understand and have confidence in the monetary framework. Directors generally commended the work done in elaborating the ECB's approach to monetary policy, which they thought both sensible and pragmatic in light of the uncertainties of the change in regime.
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> ...
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> Directors noted that the ECB had made important strides in communicating with the public, and encouraged its efforts to develop its communication strategy further. In particular, many thought that the ECB needed to provide greater detail of its assessment of inflation prospects, and be more forthcoming in explaining how it would adapt monetary policy to changing economic conditions, including changes in inflation within the range that defines price stability. A few Directors indicated, however, that there were limits to what could be conveyed by such statements of intent, given the complex considerations that went into monetary policy decisions, and that greater public understanding of the ECB's monetary policy would come from seeing the ECB in action and listening to its explanations for these actions. Some Directors thought that providing summaries of discussions in the Governing Council of the ECB would help advance its goal of communicating with the public in a clear and effective manner. Some others, however, considered that it was more important to convey to the public the main arguments underlying policy decisions, and for the ECB to speak with one voice, while ensuring an area-wide perspective, as the ECB currently seeks to do. A few

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82 See *Financial Times*, 30 October 1998.
83 *Irish Times*, 27 November 1998.
84 *Financial Times*, 12 November 1998.

Directors were of the view that the ECB should go even further by releasing minutes of the meetings of the Governing Council. A few speakers also suggested that the ECB should make public the economic models and the econometric analysis used in its decision making.[85]

[85] "IMF Executive Board Discusses the Monetary and Exchange Rate Policies of the Euro Area", *Public Information Notice (PIN)* No.99/37, 23 April 1999.

Europinion: to what extent should the ECB be independent of Member States?[86]

Country	% For	% Against
Netherlands	84	9
Luxembourg	78	15
Finland	72	14
Italy	68	10
France	68	15
Ireland	67	8
Belgium	66	13
Germany	66	16
Sweden	65	19
Denmark	63	25
Greece	62	15
Austria	61	14
Spain	56	11
UK	56	23
Portugal	53	11
EU average	64	15

To what extent should the ECB be accountable to the European Parliament[87]:

Country	% For	% Against	% Don't know
Netherlands	87	9	4
Finland	81	8	11
France	79	8	13
Luxembourg	78	15	7
Sweden	76	7	17
Greece	74	5	21
Italy	74	6	20
Denmark	73	14	13
Belgium	71	7	22
Ireland	68	4	28
Austria	68	8	24
UK	68	13	19
Germany	66	13	21
Spain	66	5	29
Portugal	57	6	37
EU average	71	9	20

[86] Taken from *Eurobarometer49* (fieldwork April-May 1998) reproduced in *Europinion*, January 1999.
[87] *Ibid*.