

Annual report of the Committee of Governors of the Central Banks on the first 18 months of stage 1 of EMU (April 1992)

Caption: In April 1992, the Committee of Governors of the Central Banks publishes its first annual report on its activities and on the monetary and financial situation in the Community. It covers the first 18 months of the first stage of Economic and Monetary Union (EMU), which started on 1 July 1990.

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**COMMITTEE OF GOVERNORS OF THE
CENTRAL BANKS OF THE MEMBER STATES OF THE
EUROPEAN ECONOMIC COMMUNITY**

ANNUAL REPORT

(July 1990 - December 1991)

APRIL 1992

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A member of the Commission of the European Communities is invited, as a representative, to the meetings of the Committee of Governors.

* Replaced K.O. Pöhl with effect from 1st August 1991.

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INTRODUCTION AND ASSESSMENT

This is the first Annual Report of the Committee of Governors on its activities and on the monetary and financial conditions in the Community. The Report has been prepared in accordance with the Committee's mandate as laid down in the amended Council Decision of 12th March 1990. It covers developments during the first one and a half years of Stage One of Economic and Monetary Union (EMU), which started on 1st July 1990.

Monetary policy co-ordination - the principal task of the Committee of Governors

The Committee of Governors was established in 1964 and has since then been the principal forum for co-operation between the central banks of the EEC Member States. On the entry into Stage One of EMU the role of the Committee was considerably strengthened and its tasks were extended. In particular, additional emphasis was placed on the promotion of the co-ordination of monetary policies with the aim of achieving price stability as a necessary condition for the proper functioning of the European Monetary System (EMS).

Although during Stages One and Two responsibility for monetary policy remains with the national authorities, the emphasis on co-ordination in the Committee's mandate reflects the recognition that both changes in the economic environment of the Community and the objective of creating EMU have greatly increased the need for compatible monetary policies. The gradual realisation of a single market, in particular the liberalisation of capital movements and the rapid integration of financial markets, and the enhanced stability of exchange rates within the Exchange Rate Mechanism (ERM) of the EMS have strengthened the interdependence between national monetary policies. As a result, the effectiveness of monetary policy in Member States is becoming increasingly dependent upon central bank co-operation. Moreover, the agreement to complete EMU within a limited number of years has made the achievement of a high degree of economic and financial convergence even more urgent. Gearing monetary policies to the attainment of a stable level of prices throughout the Community constitutes a crucial element in paving the way for a successful EMU.

The co-ordination framework

Since the start of Stage One further progress has been made in co-ordinating monetary policies, reflecting the growing consensus on the role of monetary policy and improvements in the technical aspects of the co-ordination process.

There is a firmly shared conviction in the Community that the primary objective of monetary policy is to attain price stability, as a precondition for sustainable economic growth and social equity. The attainment of price stability serves as the guiding principle for the orientation of monetary policy in all Community countries and the maintenance of price stability will be the primary objective of monetary policy in full EMU.

In order to promote this common aim, the Committee of Governors has reinforced its efforts to improve the co-ordination of monetary policies. In particular, as a complement to the monthly monitoring of current conditions in financial and foreign exchange markets, the Committee has introduced an annual forward-looking assessment of Member States' monetary policy intentions. This ex ante assessment has the purpose of evaluating their mutual compatibility before final decisions on the course of monetary policy for the following year are taken by the national authorities. This exercise is followed by regular reviews of the outturn in comparison with policy targets to assess the continued appropriateness of the stance of national policies in the light of evolving developments. In order to base these examinations on firmer technical grounds, the Committee has begun building a common analytical framework which uses a system of indicators and common assumptions on prospective economic developments, and which also involves the first steps towards improving the consistency, to the extent necessary, of the national definitions of broad monetary aggregates. Although still in the early stages of development, this technical framework has already proved valuable.

The need to strengthen the co-ordination process was heightened by the fact that monetary policies have operated in an environment where the authorities' commitment to maintain current ERM parities has become increasingly credible to financial market participants. This was a significant development, given events in this period which might have led to acute tensions: the volatility of the dollar, the Gulf War, developments

in Eastern Europe and the divergence of cyclical positions within the Community. Several factors may have contributed to the stabilisation of exchange rate expectations: the political momentum towards EMU; the trend towards more convergent inflation rates; the narrowing of current-account imbalances; and a long period without a general realignment, reflecting the pursuit of a "hard currency option" as a means of implementing anti-inflationary monetary policies. As exchange rate expectations became more stable, there was a narrowing of interest rate differentials between Community currencies. As a result, the financial linkages within the Community were reinforced and the room for independent national monetary policies was further restricted.

The co-ordinated setting of monetary policies for 1991

In the first ex ante assessment of the orientation of national monetary policies for 1991, the Committee of Governors agreed that the stance of national policies should remain geared towards a further reduction of inflationary pressures. This assessment took into account the less favourable growth prospects in many Community countries, the potential repercussions of German unification, and the uncertainties in the international environment associated with the conflict in the Gulf. The execution of monetary policy was broadly in line with the intentions. Most Member States registered a slowdown in monetary growth, generally meeting the quantified targets where these were set. At the same time, interest rate differentials narrowed markedly, with rates converging towards the German level, which even though increasing during the year, remained the lowest in the Community.

While monetary policies were in line with the course endorsed by the Committee of Governors, results in 1991 were mixed (see Summary Table). Although for the Community as a whole the rate of inflation - measured in terms of the weighted consumer price index - declined from 5.7% in 1990 to 5.1% in 1991, with some narrowing in inflation differentials, this outcome is still far from the final goal of price stability. Moreover, not only was inflation in 1991 appreciably higher than the average rate achieved over the 1986 to 1988 period, but the result was also disappointing in the light of less inflationary external conditions and weaker economic activity within the Community than had been anticipated at the time when monetary

SUMMARY TABLE: ECONOMIC AND FINANCIAL DEVELOPMENTS IN THE COMMUNITY a)

	1986-88 average	1989	1990	1991 b)
	percentage change over the previous year			
REAL GDP	3.2	3.6	2.8	1.1
CONSUMER PRICE INFLATION	3.6	5.3	5.7	5.1
COMPENSATION PER EMPLOYEE	6.1	6.2	7.5	7.1
	per cent of nominal GDP/GNP			
CURRENT ACCOUNT BALANCE c)	0.8	0.0	-0.2	-0.9
GENERAL GOVERNMENT BORROWING REQUIREMENT	4.0	2.9	4.5	4.3
	per cent			
SHORT-TERM INTEREST RATE d)	8.7	10.9	11.6	10.9
LONG-TERM INTEREST RATE e)	9.2	9.9	11.2	10.3

Source: BIS and National Data

- a) All figures are EEC weighted averages.
- b) Estimates
- c) A negative number indicates a deficit.
- d) 3-month domestic money market rate.
- e) Long-term government or public sector bond rate.

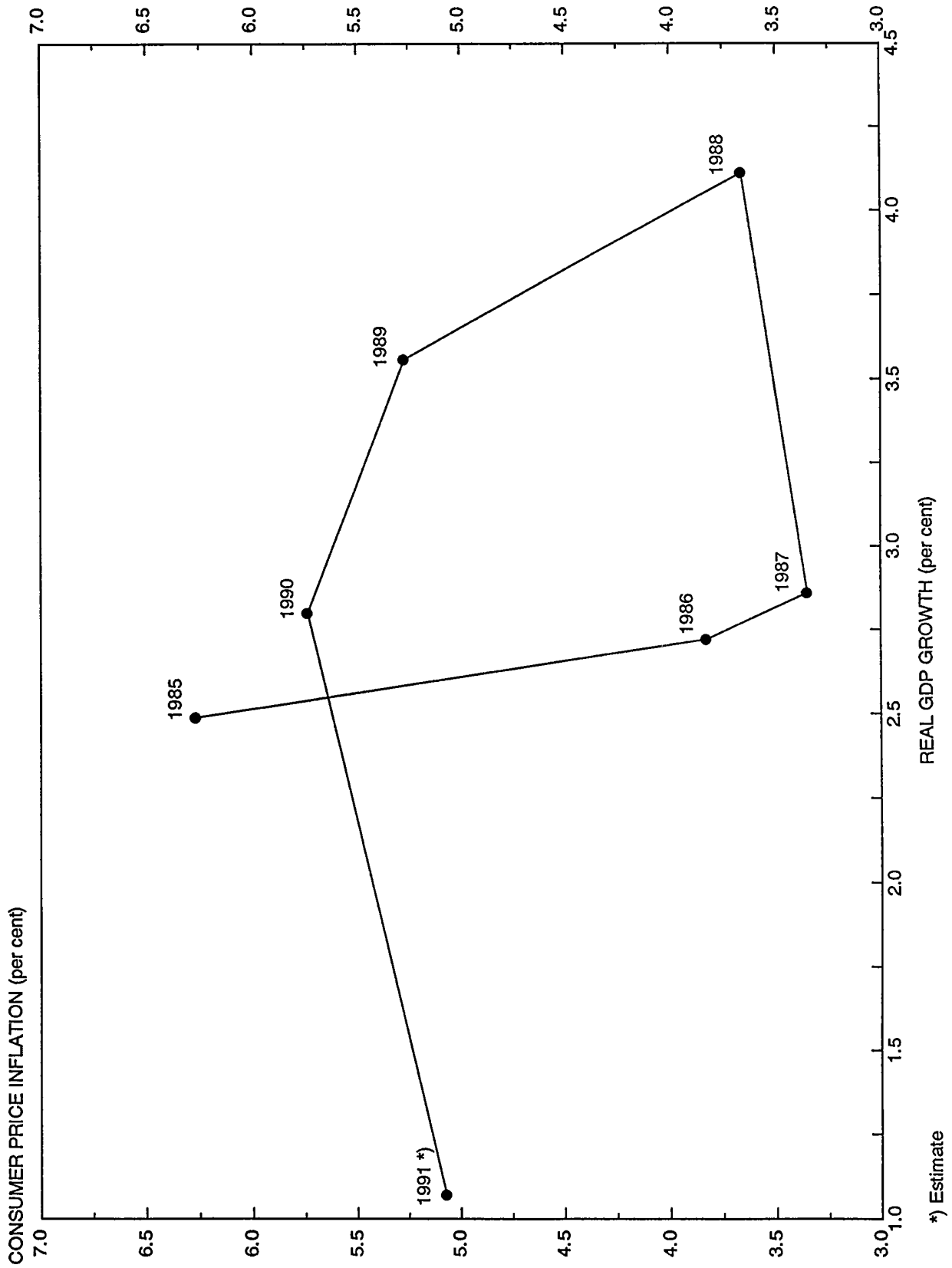
policy intentions were formulated (see Chart 1). In addition, the decline in the average rate of price increase for the Community as a whole was largely a reflection of a substantial fall in inflation in the United Kingdom, while other countries with high inflation in 1990 made only limited progress. Furthermore, inflation rose in Germany and the Netherlands, the two Member States with traditionally the lowest rates. However, some countries succeeded in maintaining relatively low rates of inflation.

The growing confidence in the prevailing exchange rate parities was beneficial for business decisions and contributed to stable conditions in financial markets. It also allowed countries with sluggish economic activity and low or rapidly falling rates of inflation to reduce interest rates in the first half of 1991 towards German levels. However, there were limits on the extent to which interest rates could be lowered without creating exchange rate tensions. This became evident in the second half of 1991, after interest rate differentials within the Community had narrowed to historically low levels. At the end of 1991, interest rates had to be raised in a number of countries to signal the commitment to maintaining exchange rate stability. Constraints on the scope for independent interest rate changes have also been faced by countries experiencing strong inflationary pressures, making it difficult to keep interest rates at levels considered high enough to fight inflation.

The importance of appropriate fiscal policies and wage developments

Both the resilience of inflation and the conflict sometimes experienced between the objective of exchange rate stability and domestic considerations highlight the importance of other factors which affect price performance, notably fiscal policies and wage developments. Budget deficits remained excessively high in a number of Member States in 1991. Indeed, the weighted average of general government borrowing requirements in the Community rose sharply in 1990, despite the fact that low deficits were maintained in several countries. Plans for budgetary consolidation in 1991 were seldom fully met, and as a result the average deficit remained well above 4% of GDP. As recent experience has shown, fiscal imbalances are not just a matter of national concern. Changes in demand and interest rates

CHART 1: REAL GROWTH AND INFLATION IN THE COMMUNITY



*) Estimate

generated by excessively expansionary national fiscal policies may affect economic and financial conditions throughout the Community and complicate the task of monetary policy in pursuing price stability. Large budget deficits within the Community have contributed to high real interest rates, which have dampened private investment and have reduced long-run growth potential.

Concerns also apply to labour market developments. Nominal wages have continued to grow rapidly in the Community in 1991, increasing on average by more than 7%, in spite of generally weaker demand conditions and rising unemployment. In this situation the co-ordination of monetary policies is not sufficient on its own to bring about price stability. If more significant progress is to be achieved in fighting inflation and creating a greater degree of economic and financial convergence, the national authorities will not only have to rein back fiscal deficits where they are excessive, but strong efforts should also be made to contain wage pressures. While these considerations apply to all Member States, they are particularly important in those which play a pivotal role in shaping the economic and financial conditions in the Community.

Lessons for 1992

The experience of the first eighteen months of Stage One was a valuable element in the assessment of the appropriate course of monetary policy in 1992. When reviewing national policy intentions and targets for the current year, the Committee of Governors was in full agreement that the thrust of the overall stance should be to promote a further decline in inflation in the Community. The monetary policies envisaged by the national authorities were considered to be consistent with this aim and should provide a significant anti-inflationary impetus. However, this appraisal was contingent upon the assumption that the fiscal consolidation and the moderation in labour cost pressures expected in 1992 would indeed be realised.

The fulfilment of these expectations is crucial since the effectiveness of monetary policies in delivering a stable price level in the Community is heavily dependent upon adequate support from fiscal and other policies - especially given the desire to safeguard exchange rate stability within the Community and the more limited room for countries to

set interest rates with a view to domestic economic conditions. Indeed, there is an urgent need in many Community countries to contain cost pressures arising from excessive wage claims, to adjust the policy mix by reducing fiscal deficits and to implement supply-side measures in order to render market forces more effective. Determined efforts in these fields are not only crucial if further progress towards price stability and a resumption of sustainable economic growth are to be achieved in 1992, but also to promote the degree of economic convergence which is necessary to underpin the existing ERM central parities in the longer run and to demonstrate the resolve to meet the conditions for entry into Stage Three of EMU.

* * *

The first part of the Report focuses on the work of the Committee of Governors. In the first Chapter the activities of the Committee are described in greater detail. The second Chapter reviews the financial and monetary developments in the Community since the beginning of Stage One of EMU. The third Chapter outlines the main features of the new monetary institutions to be established in accordance with the Treaty on European Union. The second part of the Report provides an overview of the structure and organisation of the Committee of Governors.

PART A

MONETARY ISSUES AND THE ROLE OF THE COMMITTEE OF GOVERNORS

I. ACTIVITIES OF THE COMMITTEE OF GOVERNORS

Since the beginning of Stage One, the Committee of Governors has taken further steps to strengthen the co-ordination of monetary policies. In addition, the Committee has focused on: the monitoring of developments in the European Monetary System (EMS); the institutional requirements for the second and third stages of EMU; issues in the field of banking supervision and payment systems; and relationships with non-Community countries. The Committee was assisted by the Committee of Alternates, the sub-committees and working groups, and the Secretariat and Economic Unit (see Part B of the Report).

1. CO-ORDINATION OF MONETARY POLICIES

The Committee of Governors has strengthened its efforts to promote the co-ordination of monetary policies, in accordance with its revised mandate of March 1990 (see Annex I). To this end, it has established a common framework for the monitoring of monetary policies, which includes regular examinations based on a set of commonly agreed and mutually consistent indicators.

Particular emphasis has been placed on the enhancement of the forward-looking analysis of economic and monetary trends in the Community. Each autumn, before the final decisions by the national authorities, the Committee assesses the national monetary policy intentions for the following year. This "ex ante" exercise involves, in particular, an appraisal of whether the intended intermediate objectives of national monetary policies are mutually compatible and consistent with the objective of downward convergence of inflation rates throughout the Community, taking into account the desire to preserve exchange rate stability.

The forward-looking assessments are supplemented by "ex post" surveillance exercises in which developments in economic and monetary indicators are compared with earlier projections. The causes of deviations are examined as well as the need and scope for corrective measures. In addition, the Committee of Governors has continued its practice of studying in detail, once a year, developments in public finance and their implications for the conduct of monetary policies.

The "ex ante" and "ex post" exercises make use of a set of commonly agreed indicators and, in addition, allow each central bank to take into account the assessment of the other Community central banks. To ensure the broad consistency of the national projections, the forward-looking appraisal is now based on a common set of assumptions on economic and financial prospects outside the Community. Attention is also being devoted to the development of Community-wide economic indicators, to an evaluation of the comparability of monetary statistics, and to improvements in the analytical framework for interpreting monetary aggregates and their domestic and foreign counterparts.

In the latter respects, a first step towards improving the consistency of the definitions of broad money stocks has been made, paying due regard to differences in national financial structures and behaviour and to the need to maintain a stable relationship between national monetary aggregates and the final goals of monetary policy (see Annex II). Some of the Member States have already decided to adopt the revised definitions.

2. MONITORING EMS DEVELOPMENTS

One of the main tasks of the Committee of Governors is to oversee the operation of the EMS. This activity includes the joint monitoring of current exchange rate and monetary policy developments, as well as the examination of all the other factors affecting the functioning of the EMS exchange rate mechanism.

The monitoring follows a procedure which was established by the so-called Basle/Nyborg agreement of 1987. Each month, exchange rate trends are examined and instruments used to counteract exchange market tensions are reviewed. This review takes account of economic developments and the agreement that the available instruments to reduce tension (intervention, exchange rate movements within the band and interest rate changes) should be used flexibly and concertedly to promote intra-ERM exchange rate stability.

Following the move to Stage One of EMU, the Committee of Governors has supplemented the monthly monitoring exercise with an annual examination of the functioning of the EMS. The first examination of this kind took place in December 1991 and covered all aspects of EMS operations, as well as current and prospective policy issues.

Developments in the use of the private ECU have been monitored on an annual basis since 1984. These examinations include assessments of the monetary implications of the growing financial use of the ECU, the compatibility of measures taken by national and Community authorities and the significance of legal and administrative obstacles to the use of the private ECU. The importance of these examinations has increased given the rapid expansion of the market (see Chapter II, section 2.5) and the transformation of the present ECU basket into the single currency in Stage Three of EMU.

3. WORK RELATED TO THE MOVE TO THE FINAL STAGE OF EMU

In June 1989, at its meeting in Madrid, the European Council asked the competent bodies of the Community, including the Committee of Governors, to carry out the preparatory work for the organisation of an Intergovernmental Conference to lay down the subsequent stages of EMU. In accordance with this mandate, the Committee of Governors submitted to the Intergovernmental Conference on EMU, on 27th November 1990, its proposal for a Statute of the European System of Central Banks (ESCB) and of the European Central Bank (ECB). In the course of the Intergovernmental Conference, the Committee of Governors added provisions covering more technical aspects, as well as for the arrangements for the transition to the final stage of EMU. Furthermore, on 30th October 1991, the Committee of Governors submitted its proposal for the Statute of the European Monetary Institute (EMI).

In addition to this preparatory work, the Committee of Governors followed the developments at the Intergovernmental Conference closely and provided advice in the areas of its competence. In accordance with the consultation procedure foreseen in Article 102 A of the EC Treaty, in November 1991, the Committee expressed its opinion on the Dutch Presidency's proposal for a Treaty on EMU.

The Committee of Governors has noted with satisfaction that its preparatory work was well received by the Intergovernmental Conference and that the texts agreed upon by the Heads of State or of Government in Maastricht in December 1991 reflected closely the proposals of the Committee (see Chapter III).

4. ISSUES IN THE FIELD OF BANKING SUPERVISION AND PAYMENT SYSTEMS

The revised mandate requires the Committee of Governors to hold consultations on those issues affecting the stability of financial institutions and markets which fall within the competence of the central banks. In this context, the Committee has examined certain issues arising in the field of banking supervision and payment systems.

In the banking supervisory field, the Committee of Governors has considered a range of institution-specific aspects. In particular, the closure of BCCI has led the Committee to review the implications of this case for international banking supervision in conjunction with the competent supervisory bodies.

In addition, work centred on two major topics. The first concerned the supervision of conglomerates containing a bank. In particular, the possible lack of transparency of a group's structure and operations can make it difficult for supervisors to take a group-wide financial view. This is particularly important given the possible risks of contagion from problems arising in one part of a conglomerate. A need was identified for banking supervisors to have discussions with other regulators, especially with those supervising insurance and securities markets.

The other main theme has been the definition of a common understanding on the application of the Second Banking Co-ordination Directive, which is due to come into force on 1st January 1993. Before this date, a number of practical problems need to be resolved. These concern the respective future responsibilities of supervisors both in the countries where banking institutions are operating and in those where their head office is located. In this context, valuable technical assistance has been provided by the "Groupe de Contact" - an informal group of senior EEC banking supervisors.

In the area of payment systems, a number of aspects have been studied by the Committee of Governors; part of this work is currently being prepared by a working group which has been established on an ad hoc basis.

The first issue concerns the design and operation of the ECU Clearing and Settlement System, in particular the question of whether current procedures satisfy the minimum standards laid down as a result of the G-10 work on interbank netting schemes. Prior to their implementation,

the Committee of Governors examined the intermediation facilities provided by the BIS and by some national central banks to ensure a smooth operation of the daily clearing.

The second aspect relates to the development of payment systems in the context of the Single Market and against the background of EMU. Work currently being performed is essentially of an exploratory nature and the Committee of Governors expects to draw some preliminary conclusions in the next few months.

In addition, the Committee of Governors expressed its views on the Commission's Discussion Paper "Making Payments in the Internal Market" (COM(90)447). Further discussions are now taking place in the Commission's Consultative Group on which the Committee of Governors is represented by delegates from national central banks.

5. RELATIONSHIPS WITH CENTRAL BANKS OUTSIDE THE COMMUNITY

The Committee of Governors has continued to promote the co-operation with respect to developments in exchange markets between Community central banks and the central banks of the United States, Canada, Japan, Norway, Sweden, Finland, Austria and Switzerland. This co-operation provides an important channel of information and concerns the pooling of data on exchange market developments, intervention and other official foreign exchange transactions in the so-called "concertation procedure".

Moreover, the Committee of Governors has continued the arrangements with Norges Bank agreed in 1984, which provide for regular consultations on matters of common interest. In December 1990, following the decision taken by the Norwegian authorities to peg their currency to the ECU, the Community central banks agreed to extend the bilateral co-operation with Norges Bank and concluded bilateral swap agreements governed by uniform conditions. These swap agreements, which were renewed at their maturity on 31st December 1991, give Norges Bank access to short-term funds for intervention purposes up to the equivalent of ECU 2 billion.

A number of countries outside the EMS have established unilateral links with the ECU since the start of Stage One. Norway (as from 22nd October 1990), Sweden (17th May 1991) and Finland (7th June 1991) unilaterally pegged their currencies to the ECU. With the Austrian

Schilling pegged to the Deutsche Mark for many years, the move by the three Scandinavian countries extended further the zone of stable exchange rate parities in Europe.

6. CO-OPERATION WITH OTHER COMMUNITY BODIES

In the performance of its tasks and functions, the Committee of Governors has collaborated with other Community bodies. Firstly, the Chairman of the Committee of Governors has attended the Council meetings devoted to the multilateral surveillance of member countries' economic policies and expressed the Committee's views on the consistency between monetary and other economic policies. In addition, the Governors participated in the informal ECOFIN Council meetings.

Secondly, the Chairman was invited in March 1991 to attend a meeting of the European Parliament Committee on economic and monetary matters and industrial policy. The Chairman informed the Committee of the Governors' work on the Statute of the ESCB and of the ECB as well as on the measures taken to strengthen monetary policy co-ordination.

Thirdly, close co-operation with the Commission of the European Communities has continued. Commission representatives attended the meetings of the Committee of Governors and of the Committee of Alternates, as well as most of the meetings of the sub-committees and working groups.

Fourthly, the Committee of Governors has contributed to the work of the Committee on monetary, financial and balance-of-payments statistics which was created by a Council Decision in February 1991. A member of the Secretariat has permanent observer status on this Committee, whose work aims at improving the consistency of statistical data.

Finally, the Committee of Governors has closely followed the work of the Monetary Committee. Links with this Committee are ensured by the central bank representatives, who in most cases are the Alternates of the Governors.

II. ECONOMIC DEVELOPMENTS AND MONETARY POLICY IMPLEMENTATION

1. THE ECONOMIC BACKGROUND TO MONETARY POLICY

After the strong upswing in the late 1980s, economic growth in the Community as a whole has slowed down sharply over the last two years. However, there have been marked differences in the experience of individual countries. Whereas economic conditions in western Germany remained buoyant, growth decelerated elsewhere in the Community (see Table 1). Nevertheless, inflation, which had risen in most countries in the period of rapid demand growth, is proving hard to eradicate (see Table 2). During 1991, the average inflation rate in the Community fell, although in many countries the decline was quite modest, and in some traditionally low-inflation countries inflation quickened. Economic conditions in the rest of the world, as well as German unification and other factors internal to the Community, account for these developments.

1.1 External environment

Since the middle of 1990, world economic activity has weakened more sharply than first expected, thus reducing the demand for Community exports and dampening growth in the Community. As private sector confidence was dented by the Gulf crisis, the United States economy slipped into recession in late 1990 and early 1991. Signs of a subsequent turnaround have been uneven and fragile: indications of some improvement have often been shortly followed by other signals suggesting protracted weakness. The resulting uncertainty surrounding prospects for US monetary policy and expected interest rate differentials against other major currencies triggered sharp swings in the dollar exchange rate. In the event, slow monetary growth, as well as other signs that inflationary pressures were abating, led the Federal Reserve to ease monetary policy on a number of occasions throughout the period, reducing short-term interest rates to the present low level. Elsewhere, the economic cycle in Japan lagged behind that of the North American economies and has been less pronounced, while in EFTA markets, which account for a greater proportion of Community exports than the United States and Japan combined, demand conditions have been subdued. Eastern Europe accounts for only a small share of Community countries' trade at present, and hence the reform process and the problems of the former USSR have had relatively little direct economic impact on the

TABLE 1: DEVELOPMENTS IN REAL GDP

	percentage change over the previous year			
	1986-88 average	1989	1990	1991 a)
Belgium	2.9	3.8	3.7	1.4
Denmark	1.7	0.8	1.7	1.5
Germany (western) b)	2.4	3.8	4.5	3.2
Greece	1.7	3.5	-0.1	1.2
Spain	4.7	4.8	3.6	2.5
France	2.9	4.5	2.8	1.0
Ireland	2.8	6.4	7.1	1.7
Italy	3.4	3.0	2.0	1.0
Luxembourg	5.1	7.5	3.9	3.7
Netherlands	1.8	4.0	3.9	1.9
Portugal	4.4	5.5	4.2	2.7
United Kingdom	4.3	2.1	0.9	-2.4
EEC: average	3.2	3.6	2.8	1.1
ERM: average	3.2	3.5	2.8	1.0
ERM Narrow Band: average	2.8	3.8	3.2	1.8
United States b)	3.5	2.5	1.0	-0.8
Japan b)	4.4	4.7	5.2	4.5

Source: EEC: National Data; US and Japan: OECD

a) Estimates

b) GNP

TABLE 2: DEVELOPMENTS IN CONSUMER PRICE INFLATION

	percentage change over the previous year				12 months to	
	1986-88 average	1989	1990	1991	Dec. 90	Dec. 91
Belgium	1.3	3.1	3.5	3.2	3.5	2.8
Denmark	4.1	4.8	2.6	2.4	1.9	2.3
Germany (western)	0.5	2.8	2.7	3.5	2.8	4.2
Greece	17.7	13.7	20.4	18.9	22.8	17.8
Spain	6.3	6.8	6.7	5.9	6.5	5.5
France	2.8	3.6	3.4	3.1	3.4	3.1
Ireland	3.0	4.0	3.4	3.2	2.7	3.6
Italy	5.2	6.3	6.5	6.4	6.6	6.1
Luxembourg	0.6	3.4	3.7	3.1	4.4	2.6
Netherlands	0.0	1.1	2.5	3.9	2.7	4.9
Portugal	10.3	12.6	13.4	11.4	13.7	9.6
United Kingdom	4.2	7.8	9.5	5.9	9.3	4.5
EEC: average	3.6	5.3	5.7	5.1	5.8	4.8
ERM: average	3.2	5.0	5.3	4.7	5.3	4.5
ERM Narrow Band: average	2.5	3.9	3.9	4.2	4.0	4.3
United States	3.2	4.8	5.4	4.3	6.1	3.1
Japan	0.5	2.3	3.1	3.3	3.8	2.7

Source: BIS; National Data

Community. However, given the geo-political ties between the regions and prospects of growing economic integration, Community financial markets have from time to time been affected by developments in the eastern bloc.

The slowdown in the world economy has contributed to a reduction in global inflation. Non-oil commodity prices fell sharply in the second half of 1990 to their lowest level for around three years and remained subdued through 1991. The oil price hike in the autumn of 1990 was short-lived, and in 1991 the average dollar price was only a little higher than the level preceding the Gulf crisis. Furthermore, profit margins on traded manufactured goods have been squeezed, as companies have tried to maintain market shares on both domestic and export markets. Weak world trade prices have helped to moderate inflation in the Community.

1.2 German unification

The unification of Germany in the second half of 1990 has had a profound economic impact, not only in Germany, but also in the rest of the Community.

Unification has given rise to a large fiscal expansion to support incomes and to encourage investment in eastern Germany during the difficult adjustment period. Output in eastern Germany has plummeted, although tentative signs have recently emerged that a pick-up is underway. Despite the collapse in domestic production, eastern German demand rose sharply following unification, financed largely by government transfers. This surge in demand came at a time when the western German economy was already operating at a high level of capacity. Consequently, the stimulus not only boosted output in Germany but also supported activity in other Member States. The surge in demand led to a sharp increase in German imports and a diversion of exports in 1990 and the first half of 1991 and, as a result, all Community countries have improved their bilateral trade position with Germany, in some cases by well over 1% of GDP. At the same time, the strong demand in Germany fuelled domestic inflationary pressures. These pressures have been countered by a series of increases in interest rates, which have also affected interest rate conditions elsewhere in the Community.

1.3 Economic performance and nominal convergence in the Community

In spite of the surge in output in western Germany, the cyclical downturn in the Community as a whole has proved sharper than foreseen in mid-1990. This reflected the marked slowdown in external markets and weaker

domestic spending, as real interest rates remained high and private sector confidence recovered only slowly after the Gulf War. Following six years of relatively strong growth, real GDP in the Community increased by only 1.1% in 1991, the lowest rate since 1982. As activity weakened, unemployment in the Community began to rise.

Developments at the aggregate level mask an increased cyclical divergence between the individual Member States. Although growth weakened through 1991, the level of economic activity in western Germany has remained high, in marked contrast to the recession experienced in the United Kingdom. In the other countries, growth has slowed sharply, although it remained above 2% in Spain, Luxembourg and Portugal. The only exception to the slowdown was Greece where economic activity recovered marginally.

Since the start of Stage One, the average rate of inflation and the dispersion across countries have narrowed modestly. For 1991 as a whole, consumer price inflation in the Community on a weighted basis fell only to around 5%, well above the rates of under 4% experienced in the period from 1986 to 1988. Although external influences and the slowdown in economic activity have generally been conducive to inflation reduction, persistently strong growth in wages and inadequate fiscal consolidation in many countries hindered more significant progress (see Tables 3 and 4). In addition, structural rigidities, including insufficient flexibility in labour markets, continue to hamper the disinflationary process. In the high-inflation countries, the rate of increase of prices was much lower in sectors open to foreign competition than in the more sheltered parts of the economy.

The convergence of price performance in the Community has been partly of the wrong kind, as inflation rates have risen significantly in Germany and the Netherlands, the Community countries with the best historical record in terms of price stability. This deterioration reflected a marked pick-up in wage settlements as well as increases in taxes and other public sector prices. With the exception of Italy, where the average rate of price increase in 1991 was essentially unchanged, the other Community countries succeeded in lowering inflation in 1991, although to varying extents. In the five countries (Belgium, Denmark, France, Ireland and Luxembourg) which, together with Germany and the Netherlands, had relatively low rates of inflation in 1990, the improvement was limited to a maximum of 0.5 percentage point and in most cases was less. Denmark had the

TABLE 3: WAGE DEVELOPMENTS (Compensation per Employee) a)

	percentage change over the previous year			
	1986-88 average	1989	1990	1991 b)
Belgium	2.9	3.6	5.9	5.4
Denmark	5.7	3.8	3.4	3.2
Germany (western)	3.2	3.0	4.7	6.2
Greece	13.9	17.8	20.0	16.1
Spain	7.7	6.3	7.9	8.7
France	4.6	4.6	5.4	4.7
Ireland	5.4	6.5	3.8	7.0
Italy	8.2	8.7	10.4	8.3
Luxembourg	3.7	6.5	5.2	4.7
Netherlands	2.2	0.8	3.3	4.4
Portugal	17.6	16.4	18.4	17.8
United Kingdom	8.2	9.1	9.7	8.2
EEC: average	6.1	6.2	7.5	7.1
ERM: average	5.8	5.9	7.1	6.8
ERM Narrow Band: average	4.9	4.9	6.3	6.1
United States c)	4.3	2.9	3.8	4.0
Japan c)	3.2	3.9	4.5	3.8

Source: EEC: National Data; US and Japan: OECD

a) Whole economy; increase in nominal terms.

b) Estimates

c) Data covers the business sector only, and may thus not be directly comparable with the data for the EEC countries.

TABLE 4: GENERAL GOVERNMENT BORROWING REQUIREMENTS a)

	per cent of nominal GDP			
	1986-88 average	1989	1990	1991 b)
Belgium	7.6	6.5	5.5	6.3
Denmark	-2.1	0.5	1.4	1.8
Germany c)	2.4	1.2	4.6	3.7
Greece	13.1	17.2	17.6	15.9
Spain	4.1	2.8	4.0	4.4
France	2.1	1.2	1.7	1.5
Ireland	8.5	2.2	2.6	2.4
Italy	11.1	10.0	10.6	10.2
Luxembourg	-2.2	-3.2	-3.3	-1.1
Netherlands	6.9	5.3	4.7	4.0
Portugal	10.7	6.1	6.0	5.4
United Kingdom	-0.5	-2.1	0.6	1.8
EEC: average	4.0	2.9	4.5	4.3
ERM: average	3.9	2.7	4.3	4.2
ERM Narrow Band: average	4.9	3.8	5.2	4.7
United States	2.6	1.7	2.4	2.7
Japan	-0.4	-2.4	-2.7	-2.3

Source: EEC: National Data; US and Japan: OECD

a) Negative numbers indicate a fiscal surplus.

b) Estimates

c) Up to 1989 western Germany only; 1990 on the basis of all German borrowing requirement over western German GDP; 1991 on the basis of figures of all Germany.

lowest rate of inflation in 1991 at 2.4%. Elsewhere, against a background of weak economic activity, inflation fell dramatically in the United Kingdom following sterling's entry into the ERM; in Spain, the rate declined steadily, but only slowly; and in Greece and Portugal, average inflation in 1991 dropped by between 1 and 2 percentage points, although a much sharper decline was recorded through the year.

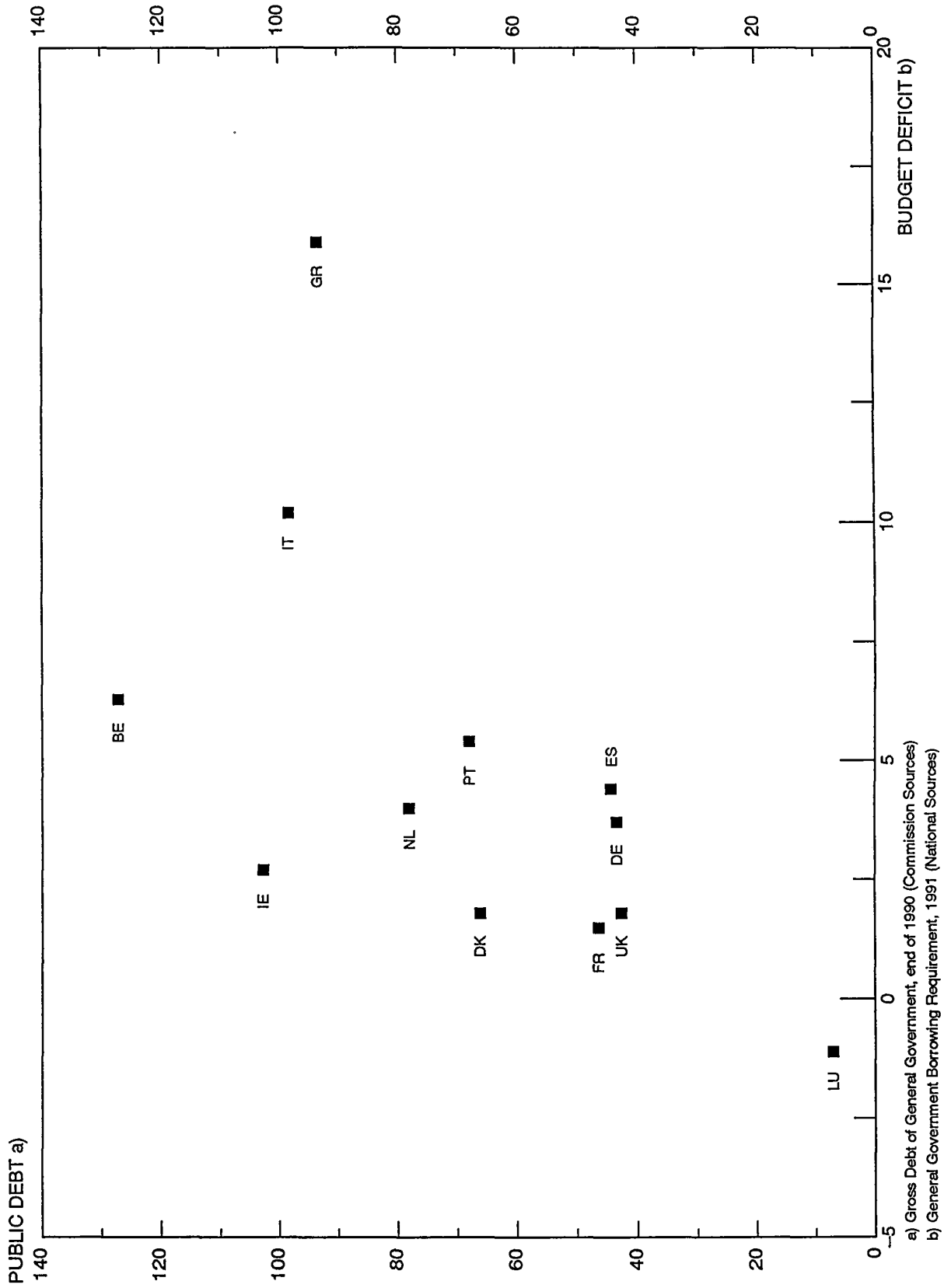
The trend towards a gradual reduction in fiscal deficits in the late 1980s has been reversed in the past two years in some countries. Although the deficit remained low in several countries, the combined deficit at the general government level rose from around 3% of Community GDP in 1989 to some 4.5% in 1990, and remained near that level in 1991. The deterioration in budgetary performance can be attributed to several factors: German unification; the slowdown in economic growth; and, in some countries, to slippage in the control of government spending. Differences in the budgetary positions of Member States remain substantial (see Chart 2). While five countries had general government deficits under 3% of GDP in 1991, at the other end of the spectrum the deficit was around 10% in Italy, and around 15% in Greece. The levels of public sector debt diverge markedly and in three Community countries remain above 100% of GDP.

Current-account imbalances in Germany and the United Kingdom have narrowed markedly over the past two years (see Table 5). In Germany, the fiscal expansion associated with unification has absorbed the previously large national savings surplus, with the current account moving from a surplus of almost 5% of GDP in 1989 to a deficit of over 1% in 1991. In the United Kingdom, the recovery of personal sector savings and the cutback in corporate investment have been reflected in a marked decline in the current-account deficit. In Greece the deficit fell from over 5% of GDP in 1990 to 2% in 1991. Elsewhere in the Community, a sizable current-account deficit persisted in Spain, financed by substantial long-term capital inflows attracted by profitable investment opportunities. The Netherlands has continued to record a large current-account surplus.

2. MONETARY AND EXCHANGE RATE DEVELOPMENTS

In Stage One, although the responsibility for monetary policy remains at the national level, the liberalisation of capital flows and

CHART 2: BUDGETARY POSITIONS IN THE COMMUNITY
(per cent of nominal GDP/GNP)



a) Gross Debt of General Government, end of 1990 (Commission Sources)
b) General Government Borrowing Requirement, 1991 (National Sources)

TABLE 5: CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS a)

	per cent of nominal GDP			
	1986-88 average	1989	1990	1991 b)
Belgium-Luxembourg	2.3	2.3	1.9	2.0
Denmark	-3.2	-1.1	1.1	1.7
Germany c) d)	4.3	4.8	3.1	-1.2
Greece	-2.9	-4.7	-5.4	-2.1
Spain	0.3	-2.9	-3.4	-3.0
France	-0.2	-0.5	-0.7	-0.5
Ireland	0.2	1.5	3.4	4.8
Italy	-0.1	-1.2	-1.3	-1.7
Netherlands	2.3	3.8	3.9	3.9
Portugal	0.9	0.4	-0.1	-1.1
United Kingdom	-1.7	-4.7	-3.2	-1.2
EEC: average	0.8	0.0	-0.2	-0.9
ERM: average	0.8	0.1	-0.1	-0.8
ERM Narrow Band: average	1.5	1.5	0.9	-0.5
United States c)	-3.2	-2.0	-1.7	-0.1
Japan c)	3.5	2.0	1.2	2.1

Source: EEC: National Data; US and Japan: OECD

a) Negative numbers indicate a deficit

b) Estimates

c) In per cent of nominal GNP

d) Up to June 1990 western Germany only.

rapid financial integration have strengthened the interdependence between national policies in the context of the ERM. Most indicators suggest that monetary policies have been firm since the start of Stage One and have thus generally favoured progress towards lower inflation in an environment of stable exchange rates between Community currencies. However, in many Member States wage and fiscal developments have not provided sufficient support to monetary policy.

2.1 The stance of monetary policy

Due to the long and variable lags in the transmission of monetary policy, the monetary stance must be appraised on the basis of medium-run trends. Developments in monetary aggregates and interest rates provide useful evidence for this assessment.

Monetary aggregates

Growth rates of the key broad monetary aggregates have moderated in most countries over the last two years (see Table 6). A deceleration is also evident in the broad monetary aggregates which have been harmonised for the internal use of the Committee of Governors (see Annex II). The slowdown in monetary growth, although partly reflecting the weakening in economic activity, indicates that monetary policies tended to exert downward pressure on inflation.

In the countries which announce targets, monetary growth has generally been within or close to the published ranges over this period (see Table 7). However, in Germany, monetary growth accelerated in late 1991, fuelled by buoyant credit demand, and as a result the target was exceeded. In Spain, the overshooting in 1991 partly reflected capital inflows. In an environment of stable exchange rate expectations and liberalised capital movements, these inflows ultimately stemmed from the substantial government borrowing requirement. A similar mechanism led to an overshooting in Italy in 1990 and Portugal in 1991. Furthermore, shifts in portfolio behaviour, often related to financial deregulation and innovation or to changes in taxation, partly accounted for deviations from targets in both directions, as experienced in Greece, Spain, France and Italy. The avoidance of distortions from financial shifts was one of the important factors behind the revisions in the national definitions of broad money in several countries.

TABLE 6: DEVELOPMENTS IN BROAD MONETARY AGGREGATES a)

	4th quarter/4th quarter percentage change			
	1986-88 average	1989	1990	1991
Belgium	9.8	10.5	6.9	7.3
Denmark	5.9	4.3	8.1	5.7
Germany b)	6.7	4.7	5.6	5.2
Greece	22.4	23.8	15.1	7.2
Spain	14.2	15.3	10.4	11.3
France	8.4	9.1	8.1	4.1
Ireland	4.8	4.6	16.7	5.2
Italy	9.1	8.8	9.9	8.3
Netherlands	4.8	13.0	6.8	5.8
Portugal	20.3	7.7	16.0	15.0
United Kingdom	16.5	18.9	12.1	5.5
United States	6.2	4.7	3.8	2.7
Japan	10.2	10.5	9.2	3.1

Source: BIS and National Data

- a) National definitions of broad money stocks are not sufficiently similar to be aggregated at the Community level (see Annex II). The following aggregates have been selected:
 Belgium: M4e; Denmark: M National; Germany: M3; Greece: M3;
 Spain: (new) ALP; France: (new) M3; Ireland: M3; Italy: M2;
 Netherlands: M3; Portugal: L-; United Kingdom: M4;
 United States: M2; Japan: M2+CD.
- b) Up to 1990, western Germany only.

TABLE 7. MONETARY TARGETS AND OUTTURNS a)

A. Countries setting targets for money supply growth

Target Variable	1990		1991		1992 Target
	Target	Outturn	Target	Outturn	
Germany M3	4-6	5.6	3-5 b)	5.2	3.5-5.5
Greece M3	19-21	14.2	14-16	11.7 (8.3) e)	9-12 d)
Spain M3 ALP	6.5-9.5	11.3	7-11	12.1 (10.9) e)	7-11 d) 8-11 d)
France M2 M3	3.5-5.5	-0.5	5-7 d)	4.1	4-6
Italy M2	6-9	9.9	5-8	8.9	5-7 d)
Portugal M3 L-	-	11.5	12	15.2	12-15 d) 12-16
United Kingdom M0	1-5	2.5	0-4	2.8 December c)	-

B. Countries setting targets for the domestic source of money supply growth

Target Variable	1990		1991		1992 Target
	Target	Outturn	Target	Outturn	
Denmark DMC f)	-	-0.9	4-7	1.3	4-7
Netherlands Bank's DMC f)	6	6	7-8	11.0	7-8

Source: National Data

a) Targets are set for a calendar year (4th qrt./4th qrt. or Dec./Dec.) except in the UK (March/March).

The 1990 and 1991 outturn columns report the corresponding growth rate of the respective variable.

No monetary target is set in Belgium, Ireland and Luxembourg.

b) Revised from 4-6% at the mid-year target review.

c) Annualised percentage change between the base period and the last month.

d) Target refers to a revised definition of the aggregate.

e) Figures in parentheses show the 1991 outturn for the revised definition to be used in 1992.

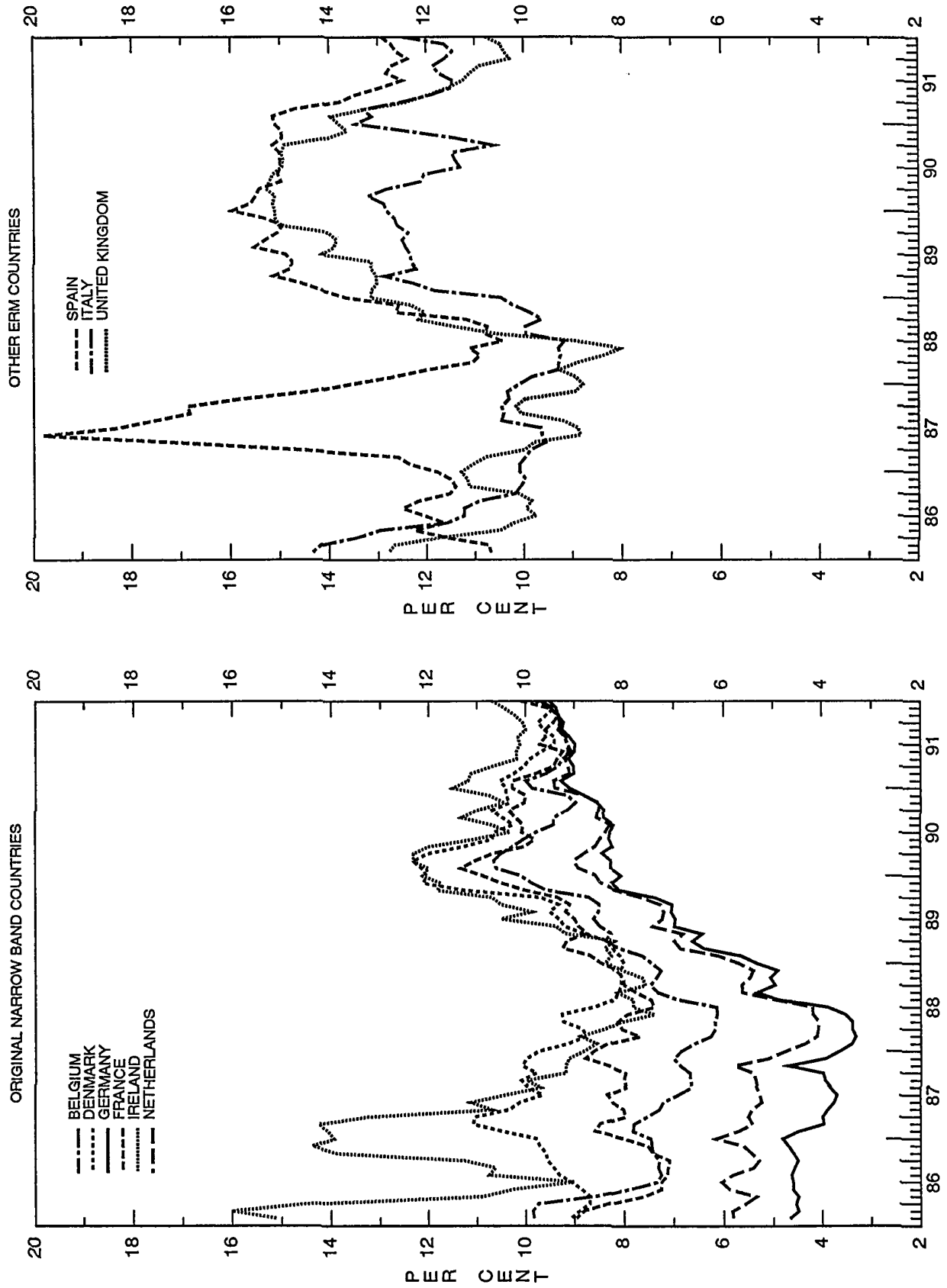
f) Domestic money creation (Denmark: growth in "Lending to residents in domestic currency + Stock of bonds dominated in domestic currency - Special deposits". Netherlands: growth in "Lending to domestic private sector + long-term lending to domestic government - domestic non-monetary liabilities").

Interest rates

In the two years prior to Stage One, there had been a significant tightening of monetary policies in the Community to counter the revival of inflationary pressure stemming from rapid demand growth. Through 1988 and 1989, three-month nominal interest rates rose on average by around 3 percentage points, with particularly strong increases in the United Kingdom and Spain, where the overheating of the economy was most pronounced (see Chart 3). The rise in short-term rates in this period exceeded the increase in inflation.

In the countries whose currencies participate in the narrow band of the ERM, short-term rates have remained rather high subsequently. Indeed, in Germany and the Netherlands rates have risen significantly over the eighteen months under review. In the other narrow-band members, rates in late 1991 had returned to their mid-1990 levels, although there had been some broadly offsetting swings in interest rates during the interim (see Chart 4). At the end of 1990, a general upward movement in short-term interest rates was triggered by concerns about unfavourable price movements, arising partly from the oil price hike in connection with the Gulf crisis, but also from adverse wage developments and widening budget deficits, especially in Germany. With oil prices returning quickly to the pre-Gulf levels in early 1991, most Community countries sought to lower short-term interest rates, although rates remained broadly unchanged in Germany and the Netherlands, as strong inflationary pressures continued. In the other countries participating in the narrow band, inflationary forces were receding and growth prospects deteriorating, and, as exchange market sentiment supported greater convergence in the level of nominal interest rates, official interest rates were reduced significantly towards the lower German levels. As a result, interest rate differentials vis-à-vis the Deutsche Mark declined to historically low levels and in some cases were largely eliminated in the first half of 1991 (see Chart 3). During the second half, the persistence of inflationary pressures and strong monetary growth in Germany led to further increases in official interest rates. As foreign exchange market sentiment suggested that limits to the reduction of interest rate differentials had been reached, the increases in German interest rates were accompanied by increases in the other narrow-band countries; in some cases interest differentials temporarily widened.

CHART 3: SHORT-TERM INTEREST RATES IN ERM COUNTRIES *)



*) 3-month domestic money market rate.

CHART 4: RECENT DEVELOPMENTS IN INTEREST RATES

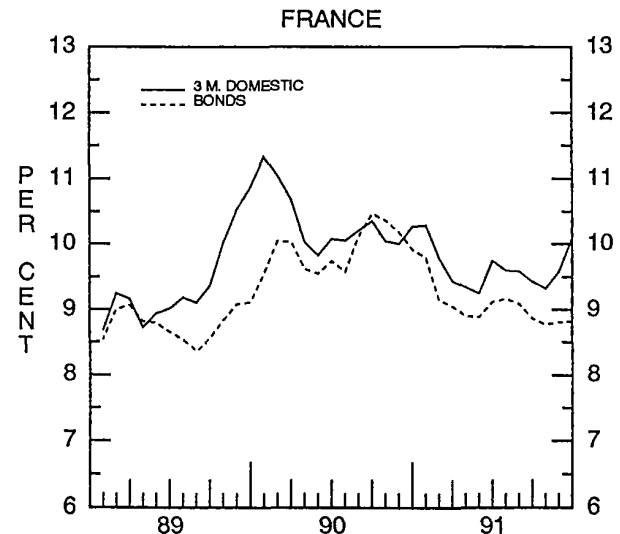
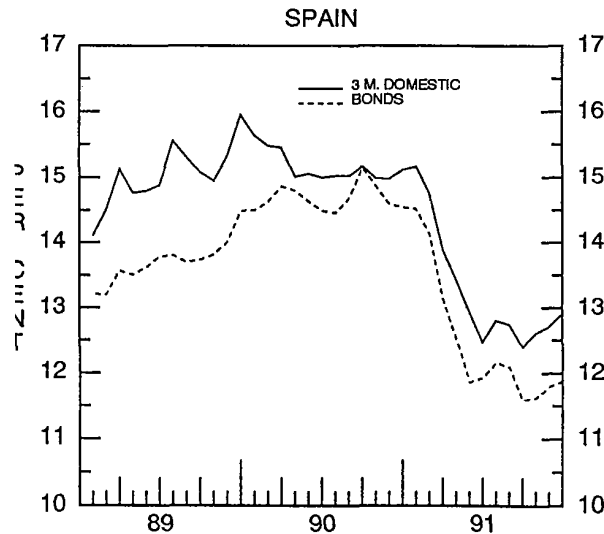
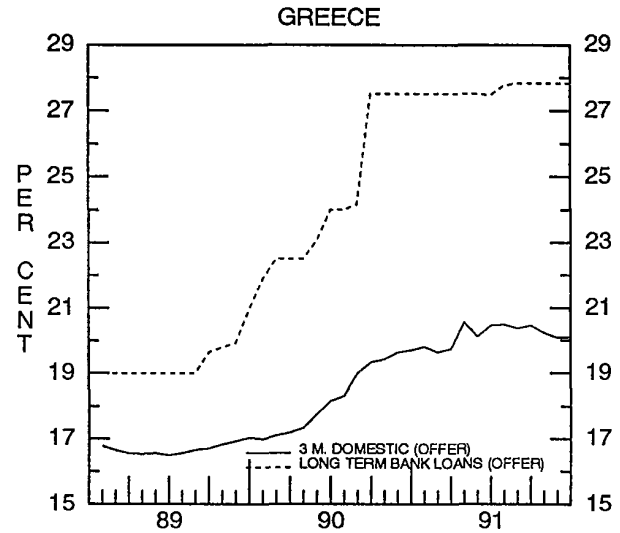
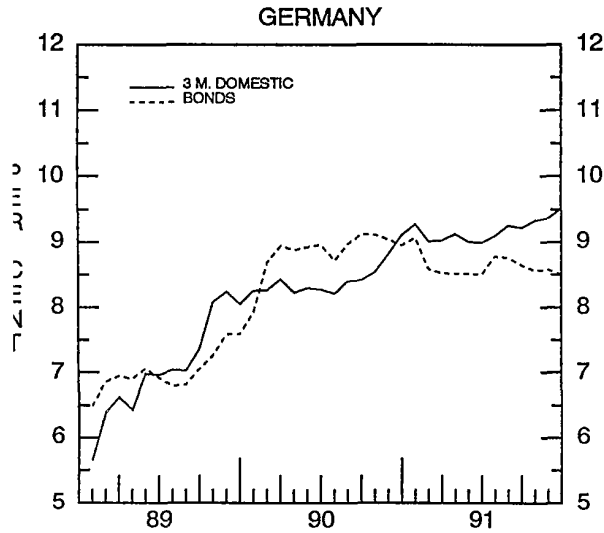
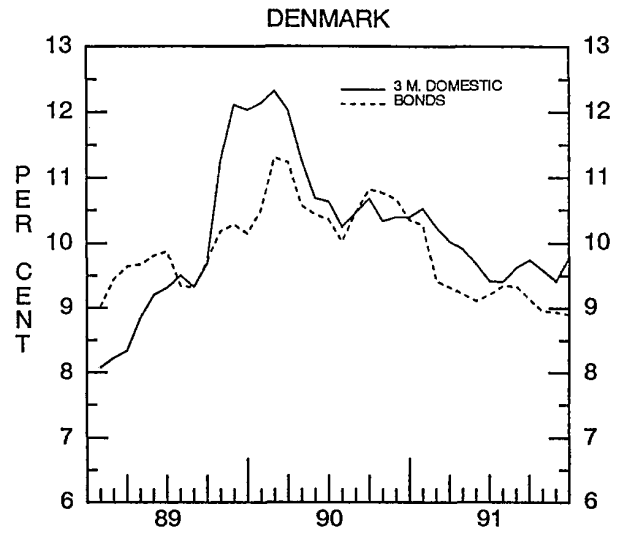
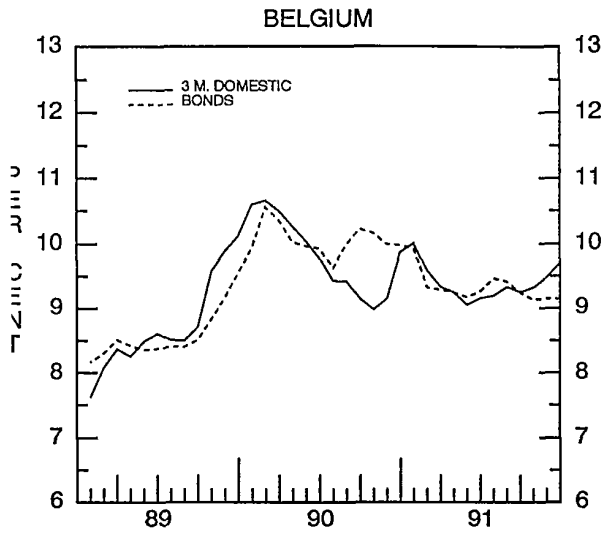
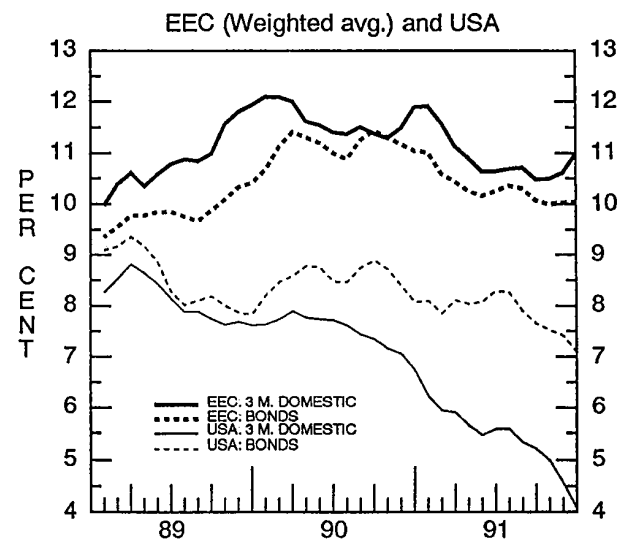
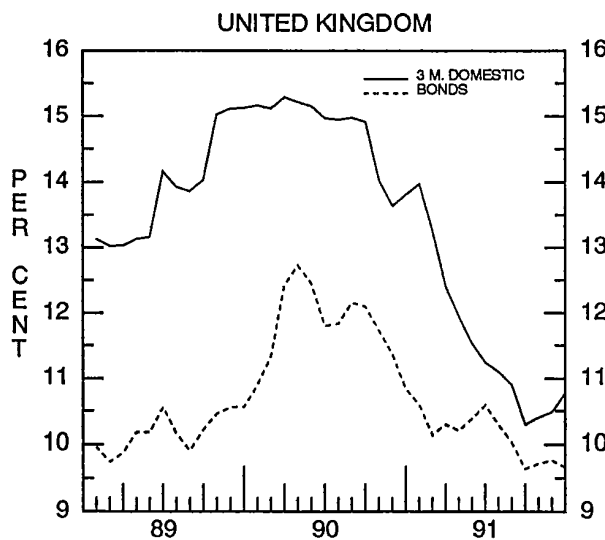
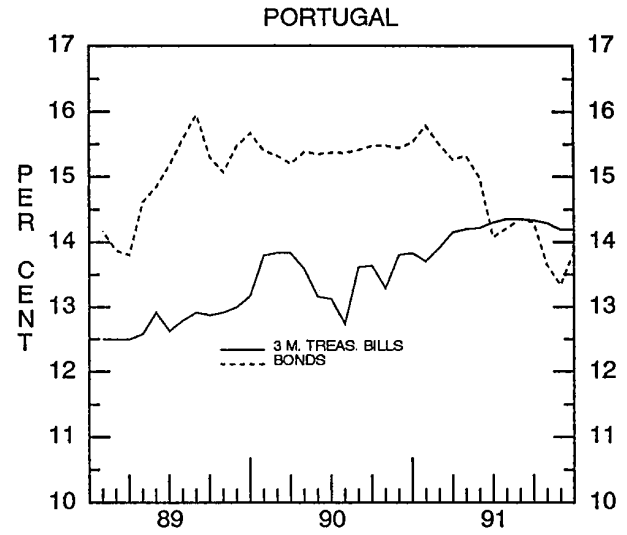
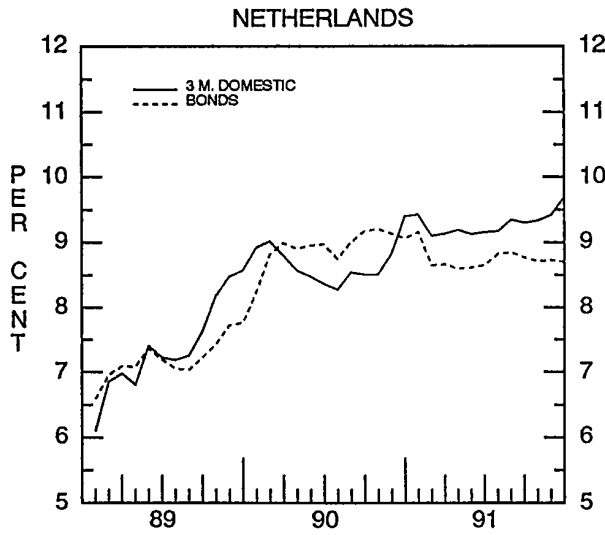
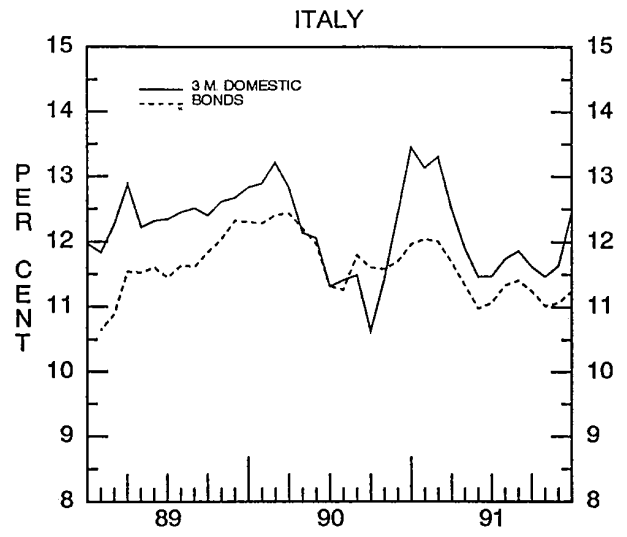
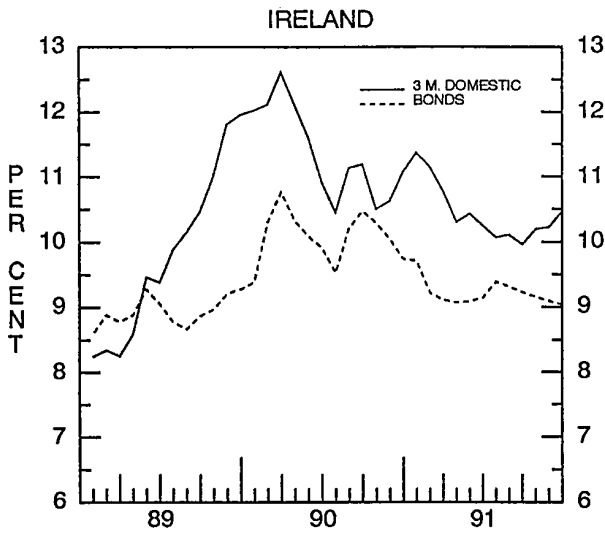


CHART 4: (continued)



In the two countries - the United Kingdom and Spain - whose currencies participate in the wide band of the ERM and where interest rates had risen particularly strongly in 1988-89, short-term rates have been reduced substantially since the start of Stage One. The decline reflected progress in reducing inflation and, in the case of Spain, also the strength of the peseta. In the second half of 1991, there were signs that limits to the narrowing of interest rate differentials between the pound sterling and the narrow-band currencies were being approached.

Outside the ERM, short-term rates rose sharply in Portugal and Greece in the second half of 1990. Rates have remained high through 1991 to signal the authorities' determination to bring inflation closer to the levels elsewhere in the Community.

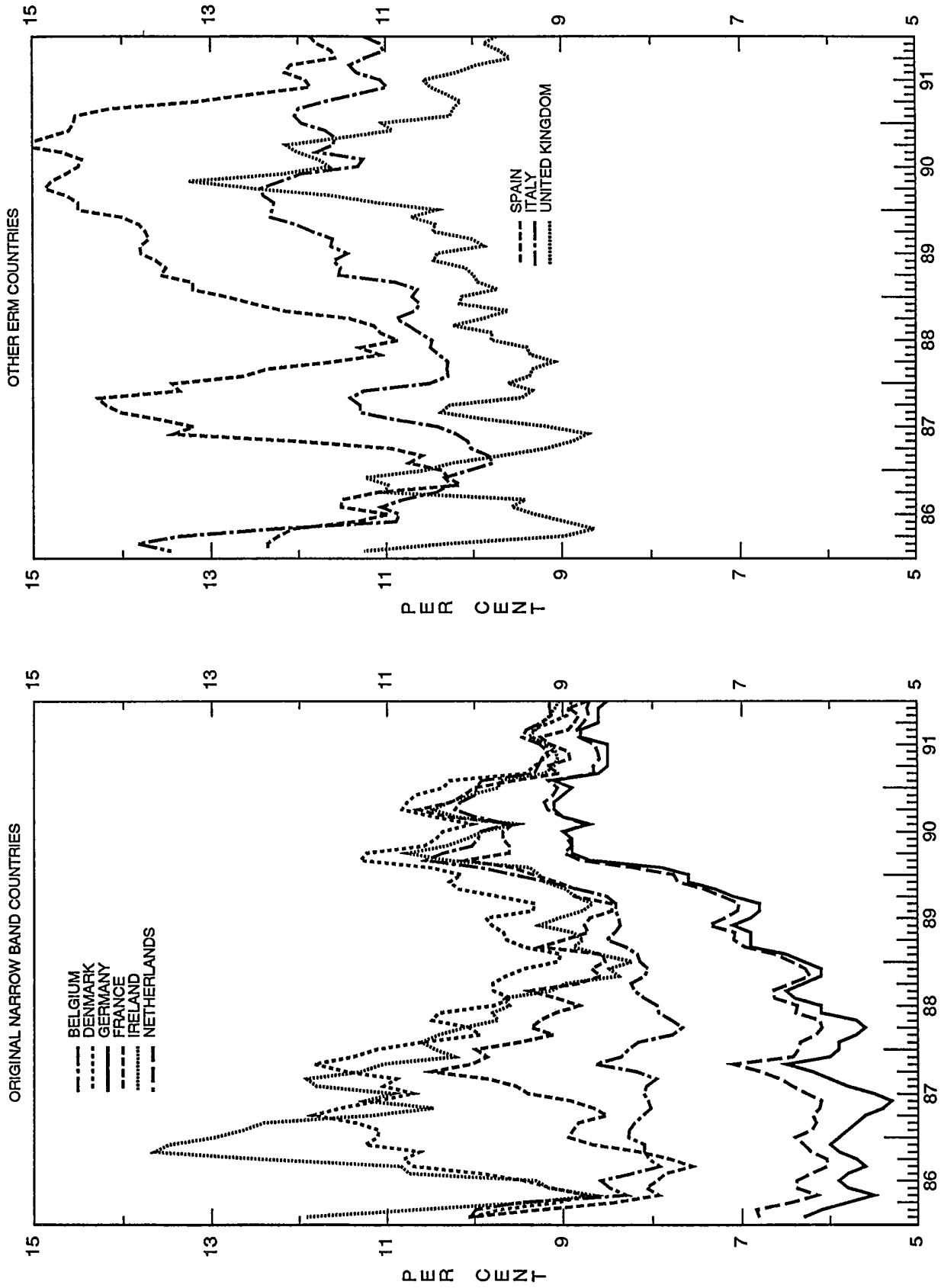
Long-term interest rates in the Community had also risen in 1988-89, but the increases were less pronounced than those of short-term rates, resulting in flatter, and in some cases inverted, yield curves (see Charts 4 and 5). Between the middle of 1990 and the end of 1991, long-term rates fell in the narrow-band countries. The decline, however, was smallest in Germany and the Netherlands and hence long-term interest rate differentials also narrowed, albeit to a lesser extent than the differentials in the money markets. As with short-term rates, long-term rates came down more sharply in Spain and the United Kingdom. Long-term rates have also fallen markedly in Portugal. Although various factors may influence long-term interest rates, their decline suggests that expectations of future inflation decreased. Long-term rates have fallen further in early 1992.

2.2 Exchange rate developments in the ERM

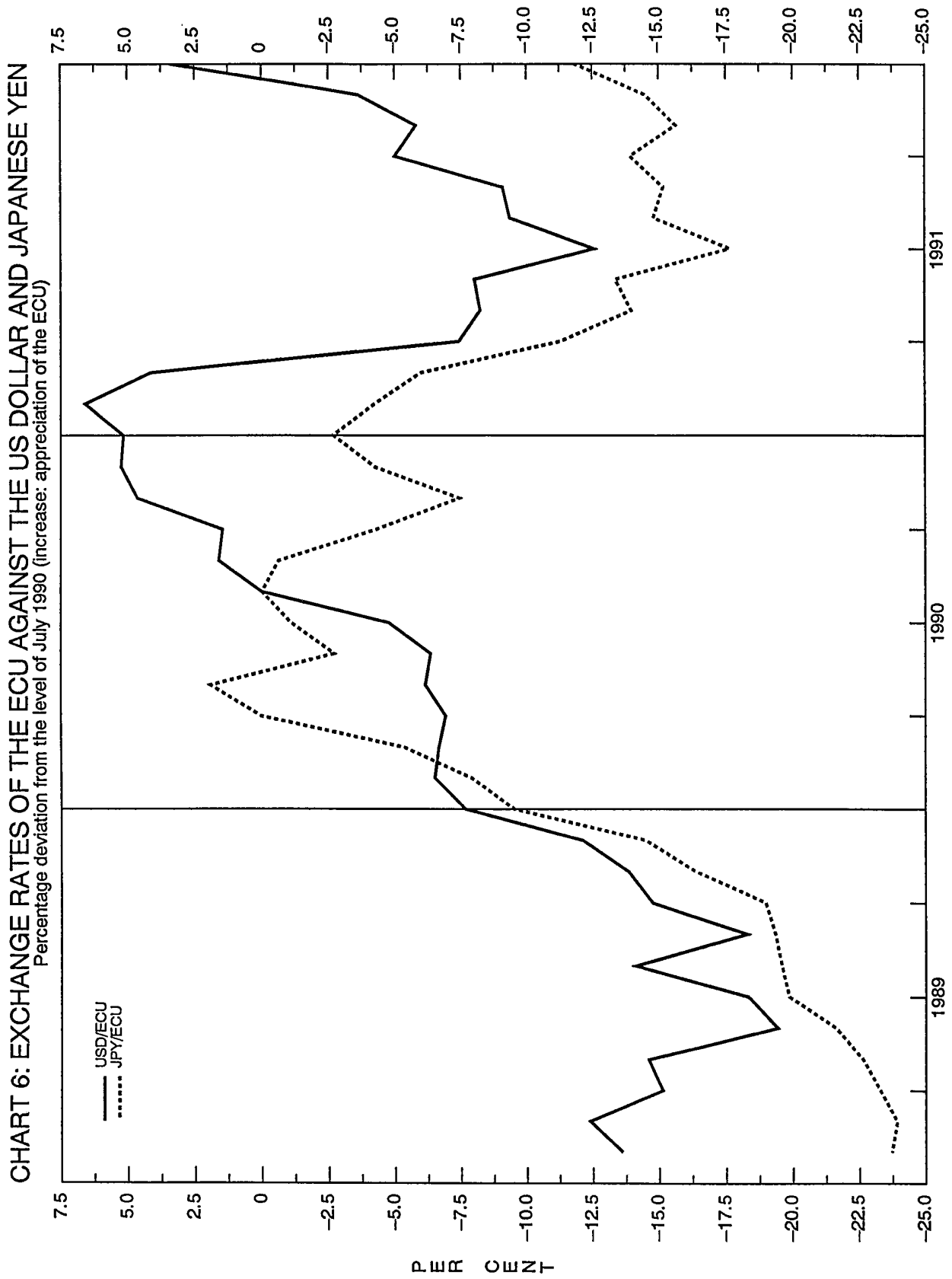
The most notable feature of recent exchange market developments has been the stability of conditions within the ERM. This stands in marked contrast to the global environment of large, and at times erratic, movements of the exchange rates of third currencies vis-à-vis the ERM currencies (see Chart 6). Participation in the ERM was extended in October 1990 when the pound sterling joined the mechanism, with a fluctuation margin of $\pm 6\%$.

The ERM has functioned smoothly since the start of Stage One and the occasional periods of tension have not seriously threatened the maintenance of central parities. The overall stability of the system is all the more striking in the light of various factors which could have resulted

CHART 5: LONG-TERM INTEREST RATES IN ERM COUNTRIES *)



*) Government or public sector bonds



in more extensive exchange rate tensions. These include the volatility of the US dollar; the considerable uncertainty associated with the Gulf crisis; political and economic upheaval in Central and Eastern Europe; and the divergence between the cyclical positions of Community countries. Possible explanations for the increase in stability of exchange rates are discussed in the next section.

The behaviour of individual currencies suggests that nominal interest rate differentials have been a major factor determining exchange rate movements in the fluctuation band, with high yielding currencies often approaching the upper margin (see Chart 7). In the wide band, the Spanish peseta remained consistently in the upper half of its fluctuation margin, sometimes reaching the upper intervention rate. In the narrow band, the Italian lira was often the strongest currency. When interest rates firmed in Germany during the second half of 1990 and again in 1991, the Deutsche Mark moved into the upper part of the narrow band, accompanied by the Dutch guilder and the Belgian franc. In contrast, in France and Denmark, where the authorities lowered interest rates when possible, their respective currencies tended to remain in the lower part of the narrow band.

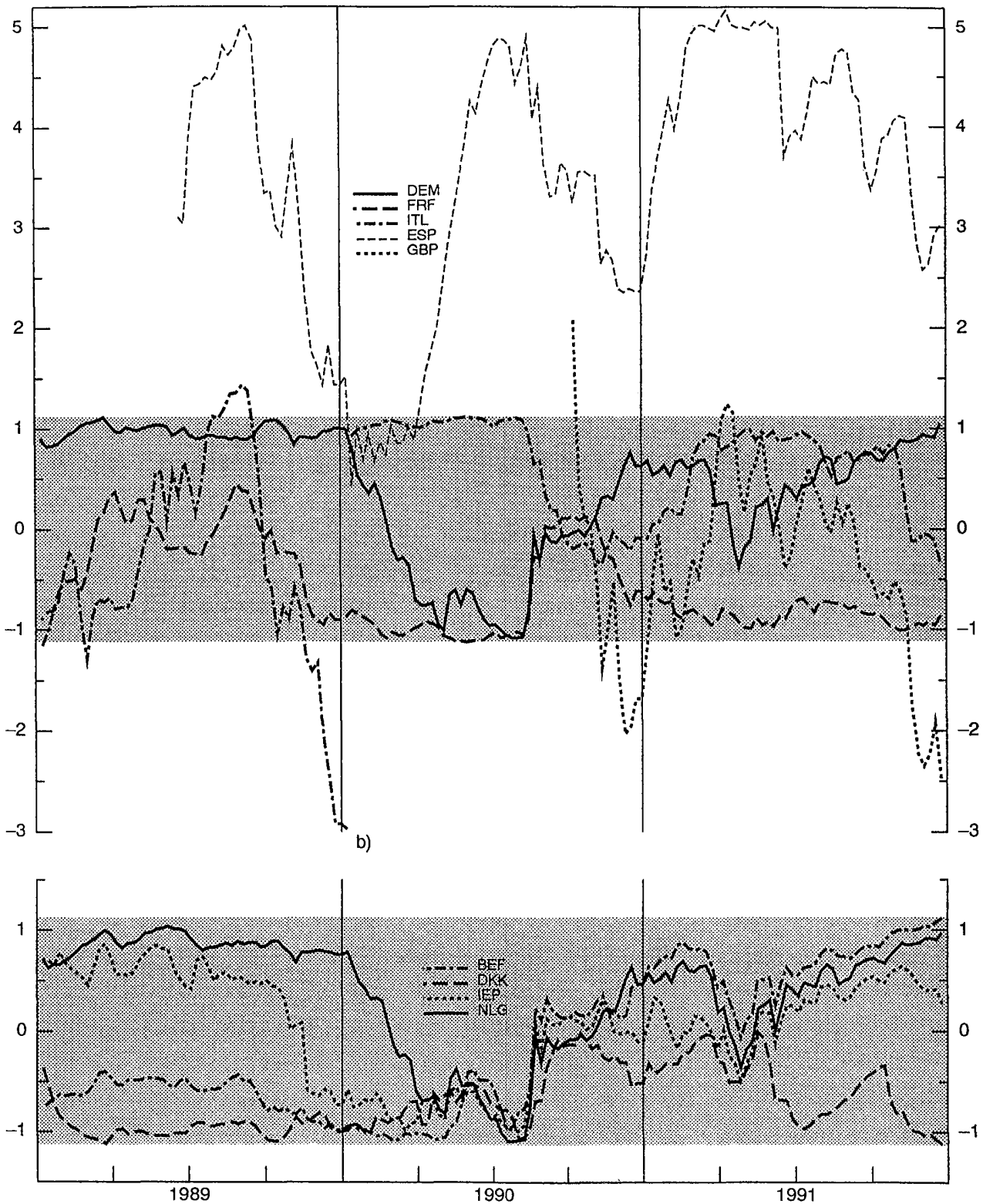
Some exchange rate strains have arisen, however, when market participants considered that interest rate differentials did not correspond to perceived exchange risks. On two occasions, in the summer of 1990 and the spring of 1991, high-yielding currencies (the Spanish peseta, joined in the first instance by the Italian lira) were for a time at, or close to, their respective upper intervention limits against a currency or currencies with relatively low interest rates (the French franc, joined in the first instance by the Deutsche Mark and the Dutch guilder). In late 1990, the currencies of some ERM countries in relatively weak cyclical positions came under downward pressure as the Deutsche Mark strengthened in response to higher German interest rates and the weakness of the US dollar. Finally, there were tensions in late 1991 related to the increase in German rates. Episodes of tension were quickly countered by the monetary authorities by intra-marginal interventions, interest rate changes and movements in the band.

2.3 Factors behind ERM stability

A major reason for the smooth operation of the ERM over this period has been the assessment by market participants that prospects for the maintenance of exchange rate parities had improved. This development is

CHART 7: POSITIONS OF ERM CURRENCIES

Weekly averages of percentage deviations from central rates a)



a) The distance between two currencies represents the percentage difference between their market exchange rate and their bilateral central parity. The Spanish peseta and the British pound entered the ERM wide band in June 1989 and October 1990, respectively.

b) In January 1990, the Italian lira entered the narrow band, and its central rate was adjusted downwards, while keeping unchanged the lower limit of the band.

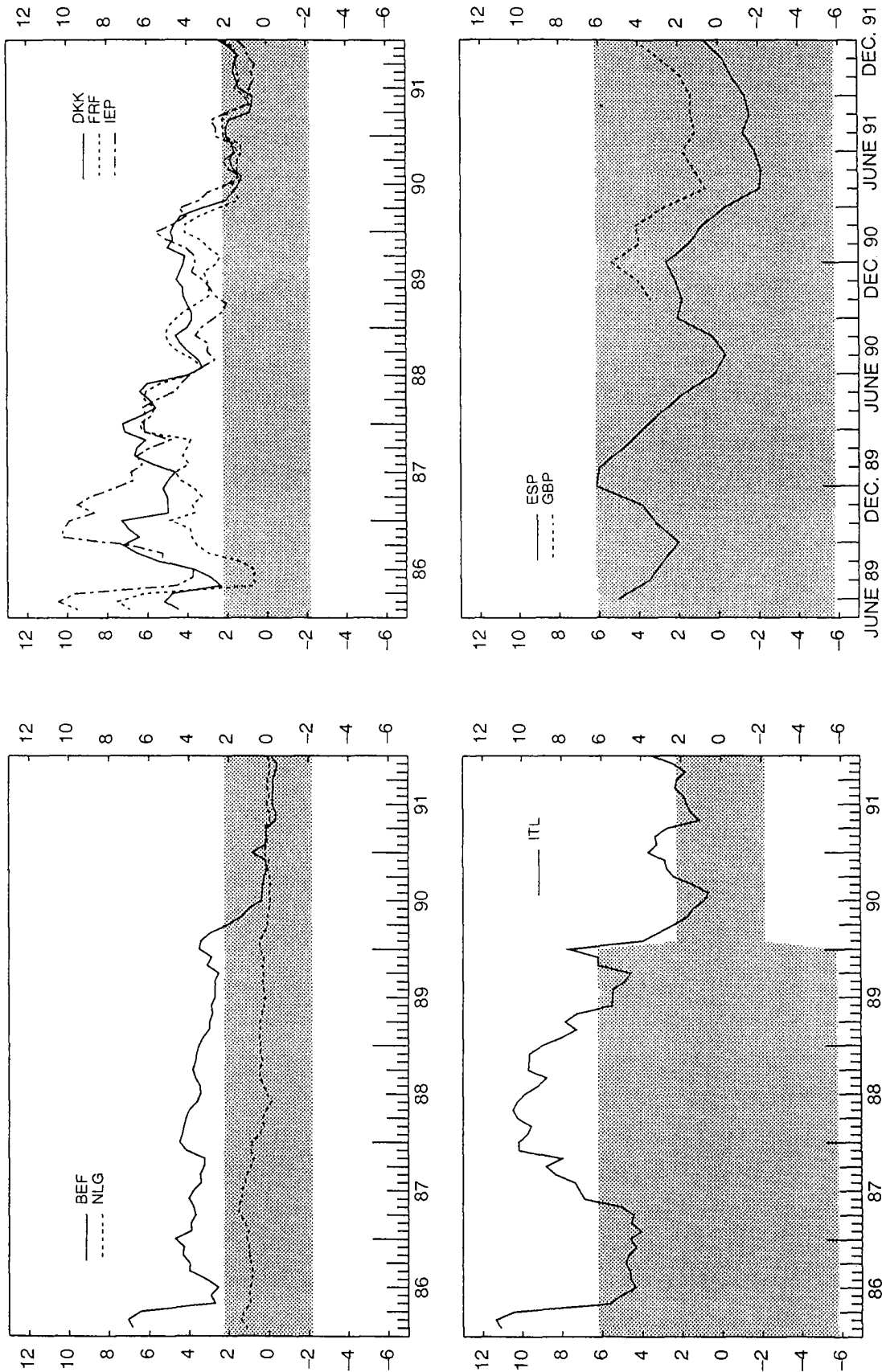
in turn linked to the effective policy measures taken by the national central banks to counter periods of tensions. As market participants expected authorities to counteract exchange market tensions, the incentive to take foreign exchange positions in favour of a realignment was reduced. As a result, the stabilising properties of the system were reinforced.

While difficult to assess and to quantify, evidence from two sources suggests that market expectations of a realignment diminished in the period under review. A first indicator, which sheds some light on short-run expectations, is the forward exchange rate. If the forward exchange rate is outside the maximum range allowed by the fluctuation band, this can be interpreted as signalling the expectations of a realignment over the relevant time horizon. Indeed, the above indicator using the twelve-month forward rates vis-à-vis the Deutsche Mark suggests that market expectations of a realignment have been the lowest since the inception of the EMS (see Chart 8).

A second indicator of exchange rate expectations is provided by long-term interest rate differentials, which supply information on the credibility of parities over a longer period. Although the differential should be interpreted with caution because of the different maturities, fiscal treatment and liquidity of the bonds being compared, the progressive reduction in long-term interest rate differentials vis-à-vis the Deutsche Mark during Stage One again suggests stronger market confidence in the maintenance of central parities in the ERM (see Chart 5).

Strengthened market confidence may be ascribed to several factors, some reflecting structural and political developments as well as others of a conjunctural nature. Firstly, the absence of a general realignment since January 1987 demonstrates policy-makers' growing awareness of the potential drawbacks of changes in parities, both in terms of the resulting inflationary stimulus and the damage to the credibility of their "hard currency policy". Moreover, the removal of capital controls and the political momentum towards EMU have further added to confidence in the authorities' commitment to exchange rate stability. Secondly, differences in inflation performance in the Community have declined, and the largest current-account imbalances in countries participating in the ERM have narrowed. Finally, market perceptions of the impact of German unification tended to reduce the relative strength of the Deutsche Mark in the ERM for much of this period, easing the pressures on other currencies associated

CHART 8: FORWARD EXCHANGE RATES IN THE ERM *)



*) The lines for each currency give the percentage deviation of the 12-mth. forward rate from the ERM bilateral central rate vis-a-vis the Deutsche Mark. The shaded area represents the bilateral fluctuation band against the Deutsche Mark

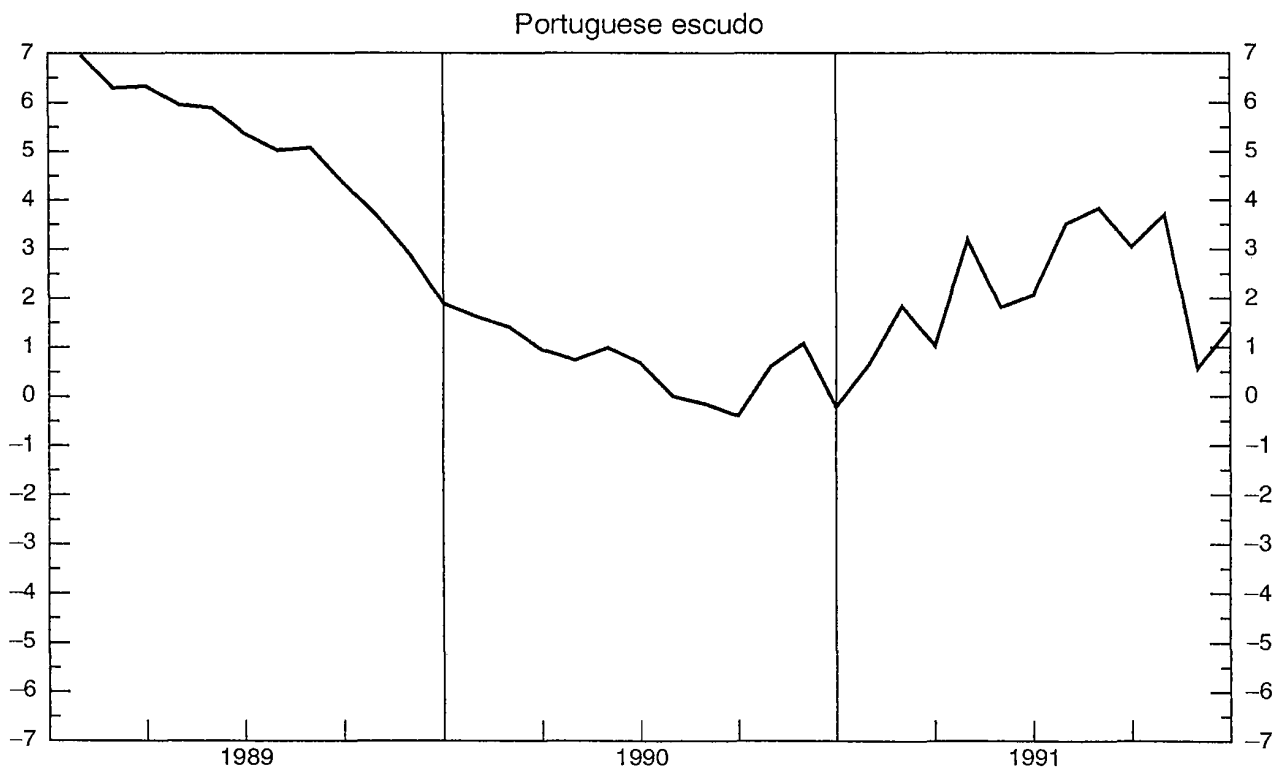
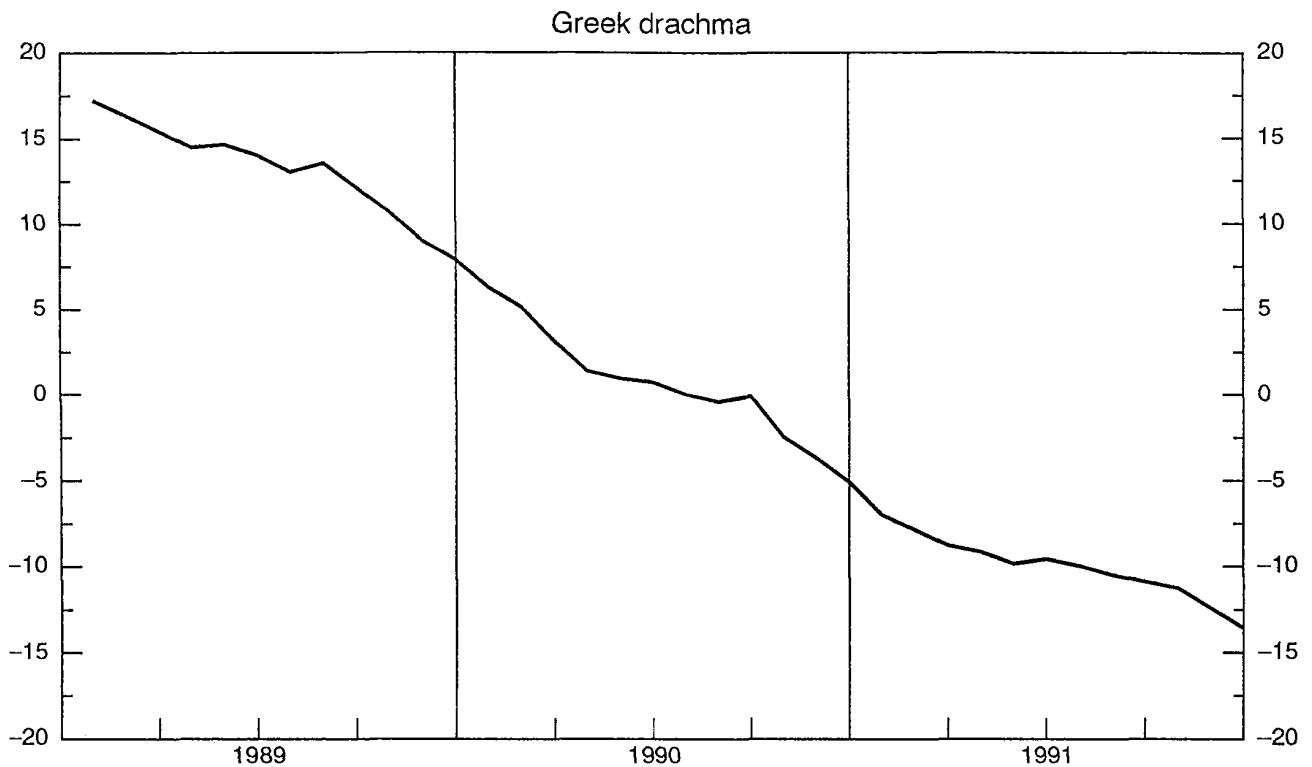
with the maintenance of high interest rates in Germany. However, the Deutsche Mark regained its relative strength in the ERM in the second half of 1991, as the Deutsche Bundesbank raised official interest rates twice to reaffirm its determination to continue a stability-oriented monetary policy.

Monetary authorities have also fostered stability by reacting quickly and effectively to episodes of exchange market tensions. Policy responses complied with the principles of the 1987 Basle-Nyborg Agreement, which calls on the authorities to make flexible and co-ordinated use of interest rate changes, intervention, and the scope for movement within the band. The relative importance of the instruments employed differed from country to country, depending on the authorities' assessment of the source of the tensions and of the likely impact of the policy change on domestic economic conditions. While in some countries - such as Belgium and the Netherlands - the authorities relied primarily on changes in interest rates, in others - such as Italy and the United Kingdom - the scope for exchange rate movements within the band has been used more actively. The intensity and frequency of foreign exchange market intervention also differed, but it is noteworthy that intervention was in general accompanied by the use of other instruments.

2.4 Exchange rate policies of non-ERM countries

Portugal and Greece have strengthened to different degrees the links between their currencies and those participating in the ERM to assist the fight against inflation and to prepare the ground for eventual entry into the mechanism (see Chart 9). With effect from 1st October 1990, Portugal abandoned its long-standing crawling-peg policy and allowed the escudo to fluctuate within an undisclosed band against a basket of ERM currencies. The high interest rate differential in favour of the escudo attracted large capital inflows, complicating monetary management and contributing to an overshooting of the monetary target. This was counteracted by the temporary re-imposition of controls on short-term capital flows. In Greece foreign exchange policy is also geared towards inflation reduction. Drachma depreciation no longer fully offsets the inflation and labour cost differentials vis-à-vis major trading partners, thus adding to competitive pressures in the economy.

CHART 9: EXCHANGE RATES OF THE GREEK DRACHMA AND PORTUGUESE ESCUDO *)
(AGAINST ERM CURRENCIES)



*) Percentage deviation from the level of July 1990 (increase = appreciation of GRD or PTE)
ERM corresponds to a weighted average of the ERM currencies (using normalised ECU weights).

2.5 Developments in the Private ECU

The official ECU, defined as a currency basket composed of specific amounts of the currencies of the EEC Member States, came into existence in March 1979 at the inception of the EMS. It is used within the EMS to express the central exchange rate of participating currencies, to denominate certain claims and liabilities, and as a reserve instrument. The introduction of the official ECU has stimulated the evolution of a market in private ECUs, created by commercial banks. This market is being used on a significant and growing scale by public authorities and by the private sector. To date, the most important usage of the private ECU has been in financial domain (see Table 8). The ECU still has to make a breakthrough in the non-financial sphere; its use as an invoicing currency and as a means of settlement of non-financial transactions remains very limited.

There is a substantial bond market denominated in private ECUs, with outstanding bonds amounting to ECU 110 billion at the end of September 1991. The share of total international bond issues denominated in ECU has been rising sharply; it was 12% in the first nine months of 1991 (compared with 34% for the US dollar and 11% for the Japanese yen), making it the second most commonly-used currency for international bond issuance in that period. Furthermore, there is a sizable market in short-term ECU securities, both in the form of Treasury bills and commercial paper.

The ECU banking market has also attained a significant scale, with nearly ECU 180 billion of lending outstanding at end-September 1991, of which ECU 46 billion represented loans to non-banks. ECU banking is continuing to expand strongly at a time when the overall market, and all other major currency sectors, are contracting. Furthermore, whereas in the past the growth of ECU banking business was dominated by a demand for ECU credit, since 1989 there has been a tendency for ECU deposits to grow faster than ECU lending. This tendency was partly related to the accumulation of ECU reserves by central banks; as a result, the banking system has gradually reduced its net asset position and has become a net borrower of ECUs as from 1991.

The strong expansion of ECU markets appears to have been related to continued market perception of the ECU's merits as a vehicle to hedge against exchange and interest rate risks. In addition, the Intergovernmental Conference on EMU and the prospective role of the ECU in the Third Stage appear to have stimulated the financial use of the private

TABLE 8: ECU FINANCIAL MARKETS a)

	ECU billion outstanding (end of period)		
	Dec. 1989	Dec. 1990	Sep. 1991
International Bonds	45.9	54.7	72.3
Domestic Bonds	24.4	35.2	39.2
Treasury Bills	10.3	8.4	7.9
Euro-commercial paper and notes	2.9	6.1	9.7
Bank Assets	128.2	148.6	175.7
- interbank	(97.4)	(114.3)	(129.8)
- other	(30.8)	(34.3)	(45.9)
Bank Liabilities	116.9	149.8	180.9
- interbank	(92.4)	(118.2)	(143.1)
- other	(24.5)	(31.6)	(37.8)
Memorandum Item: Central Banks' holdings of private ECUs	17.0	27.1	34.1

Source: BIS

- a) There is an overlap, in particular between the securities and banking markets, owing to the role of banks as both issuers and holders of ECU securities; thus the total size of the market is less than the sum of the individual markets given in this table.

ECU. It should also be recalled that the authorities of some Community countries and supranational institutions continue to play an important role in the ECU financial markets. For example, around half of the outstanding stock of international ECU bonds have been issued by national governments and international institutions, predominantly in the Community, with the balance of the funds borrowed by the business sector.

Some central banks also hold the private ECU as a reserve asset. At the end of September 1991 central banks together held ECU 34 billion of such reserves. In many cases these assets were acquired from the proceeds of government borrowing in ECUs. On a number of occasions central banks have undertaken intervention in private ECUs in the foreign exchange market.

Derivative financial products in ECUs have been launched by the London and Paris Futures exchanges, including an ECU long-bond future and a three-month interest rate future.

3. PROSPECTS AND MONETARY POLICY ISSUES

When conducting the second ex ante co-ordination exercise, which examined national monetary policy objectives for 1992, the Committee of Governors reviewed forecasts of economic and monetary developments in the Community. In judging the appropriate thrust of monetary policy, particular attention was paid to the large margin of uncertainty surrounding these projections and the assumptions underpinning them.

3.1 Economic prospects

Forecasts presently indicate that a modest upturn in world economic growth is in prospect in 1992, which will provide a stimulus to activity within the Community. In the United States, the hesitant recovery is expected to gain momentum as the year progresses. Nevertheless, growth for the year as a whole is likely to be much lower than experienced in the early stages of past upswings. The Japanese economy may continue to slow in the early part of the year, although recent cuts in interest rates and budgetary measures are expected to limit the cyclical downturn. Activity in the EFTA countries may pick up moderately. However, given the close trade integration with the Community, the recovery expected in EFTA markets hinges in turn on a prospective upturn in Community markets. World trade

prices are likely to remain relatively soft in 1992, leading to only small increases in import prices in the Community.

Against this slowly improving international background, and signs in many countries that domestic conditions are gradually beginning to turn around, an upturn in economic growth in the Community is expected in the course of 1992. Forecasts produced in the autumn indicated that aggregate economic activity in the Community may expand by about 2% for the year as a whole, a rate of growth which would not exert pressures on capacity and labour utilisation. More recent data, however, suggest that the outcome could be less favourable.

A marked reduction in the divergence of annual growth rates in the Community is likely in 1992. Growth in western Germany will be lower, following several years of extraordinary buoyancy, whereas in the eastern Länder a sharp turnaround is expected. On the other hand, most Community countries may have passed the cyclical trough, although the speed and strength of the recovery remain uncertain.

Some improvement in convergence in budgetary positions has been assumed for 1992 on the basis of government intentions, although the overall fiscal imbalance in the Community is likely to remain large. A radical fiscal tightening is planned in Greece and Italy to make up the ground lost in 1991 and to move budgetary positions closer to a sustainable medium-term basis. In the other countries with either high levels of debt or deficits, a relatively firm fiscal stance is expected by the national authorities, although the prospective reductions in budgetary deficits are fairly small in most cases. At the Community level, the planned consolidation in the high deficit countries may be largely offset by an increase in the budget deficits in some countries with both relatively low debt and deficits, where cyclical conditions remain relatively weak.

As far as labour cost pressures are concerned, some slowdown in wage growth was expected in the ex ante exercise for monetary policy co-ordination. This was based on the assumption that the resistance of firms to meet high wage claims would stiffen in an environment of relatively weak demand and strong competition, as well as that incomes policies, where applied, would be strengthened. Moreover, should activity recover as expected, there may also be a cyclical improvement in productivity, which would contribute to a moderation of unit costs.

3.2 Monetary policy prospects

In the ex ante co-ordination exercise, the Committee of Governors considered that the national monetary policy intentions for the current year were consistent with the objective of reducing inflation in the Community. This assessment, however, was contingent upon the assumption that price developments would not be threatened by a number of factors outside the control of the monetary authorities. In this respect, not only may the assumptions about the international environment prove too optimistic, but there are also risks in a number of countries that plans for fiscal consolidation will not be realised, adding to the overall fiscal pressure in the Community, and that cost pressures will not abate as expected. If these risks materialise, monetary policies will have to be reviewed, and, if necessary, revised taking due account of their primary objective of promoting price stability.

The task of monetary policy co-ordination will continue to prove difficult, as long as significant divergences persist between national economic conditions. In the last two years, foreign exchange market expectations have led to pressures for a marked narrowing of interest rate differentials in the Community. As a result, the scope for setting interest rates with a view to national economic conditions has become rather restricted. If the benefits of exchange rate stability are to be preserved, a monetary response to shocks originating in one country - especially if that country plays an important role in shaping economic conditions throughout the Community - would be quickly transmitted to the other Community countries. In this situation, there is a risk that a monetary tightening to counteract unfavourable price developments in some Member States will conflict with the desire for lower interest rates in countries with a low, or rapidly falling, rate of inflation and weak economic activity. However, the resulting policy dilemmas between domestic objectives and the desire to maintain exchange rate stability cannot be resolved by monetary policies alone. The high degree of integration in the Community and the interdependence between the national economies imposes constraints on all areas of national macro-economic management. The primary objective of monetary policy is to promote price stability throughout the Community and it is against this objective that the success and effectiveness of monetary policy will be judged. As long as strong price

pressures continue in a number of countries, there will be severe limits to the scope for easing the overall monetary conditions in the Community.

The difficulties involved in co-ordinating monetary policies in the presence of divergent national conditions, as well as the costs associated with an unbalanced policy mix, make it of the utmost importance that plans for fiscal consolidation are realised and that excessive wage claims are contained. Progress in these fields is essential not only to achieve a marked reduction in inflation in 1992 but also to strengthen the foundations underpinning exchange rate stability in the Community and to prepare for entry into Stage Three of EMU.

III. THE PRINCIPAL FEATURES OF THE NEW MONETARY INSTITUTIONS IN STAGES TWO AND THREE OF ECONOMIC AND MONETARY UNION

In December 1991 the Heads of State or of Government agreed on the text of a Treaty on European Union which lays the legal and institutional foundations for an advancement towards a Political Union and the establishment of Economic and Monetary Union. The Treaty was signed on 7th February 1992 and is expected to be ratified by the Member States in the course of 1992.

The realisation of EMU in accordance with the new Treaty will have a significant impact on all aspects of economic management in the Community. Essential elements of economic union will be economic policy co-ordination and rules aimed at the avoidance of excessive budget deficits. However, the consequences of the realisation of EMU will be most profound in the field of monetary policy. Possibly soon after end-1996 - if the necessary conditions for entering Stage Three of EMU are found to have been met - but at the latest on 1st January 1999, the responsibility for monetary policy in the participating Member States will be transferred from the national level to the European System of Central Banks (ESCB). In order to ensure that the groundwork for the unprecedented move to a single, centrally decided monetary policy is laid, a European Monetary Institute (EMI) will be set up at the start of Stage Two on 1st January 1994. The EMI, which will be liquidated on the establishment of the ECB, will not only strengthen further the co-ordination of national monetary policies but will also prepare the necessary regulatory, organisational and logistical framework for the ESCB to perform its tasks.

The Statutes of these two institutions (which are reproduced in Annexes III and IV) closely reflect the proposals made by the Committee of Governors as its contribution to the preparatory work for the Treaty on European Union.

1. THE EUROPEAN SYSTEM OF CENTRAL BANKS

Article 109l(4) of the new Treaty states that: "At the starting date of the third stage, the Council shall, acting with the unanimity of the Member States without a derogation, on a proposal from the Commission and after consulting the ECB, adopt the conversion rates at which their

currencies shall be irrevocably fixed and at which irrevocably fixed rate the ECU shall be substituted for these currencies, and the ECU will become a currency in its own right. This measure shall by itself not modify the external value of the ECU. The Council shall, acting according to the same procedure, also take the other measures necessary for the rapid introduction of the ECU as the single currency of those Member States".

The irrevocable fixing of exchange rates rules out any possibility of participating countries continuing to pursue independent monetary policies. Monetary Union thus implies the loss of monetary policy autonomy at the level of the national central banks and the adoption of a single monetary policy which, in accordance with the Treaty, will be defined and implemented jointly in the framework of the ESCB. The ESCB will operate in accordance with the provisions of the Treaty and of its Statute (see Annex III).

1.1 Objectives of the ESCB

The transfer of national decision-making power over monetary policy underscores the necessity for a clear consensus on the objectives, tasks, and operational features of the System. Building on the firmly shared conviction that price stability is a precondition for sustainable economic growth, the principal task of the ESCB is stated unequivocally: "the primary objective of the ESCB shall be to maintain price stability". This should not be misinterpreted as implying that monetary policy will be conducted single-mindedly, with no regard to the other objectives of economic policy, as the Statute also requires the ESCB "to support the general economic policies in the Community", providing this takes place "without prejudice to the objective of price stability".

1.2 Organisational features of the ESCB

The organisational structure has been designed to ensure an effective achievement of the primary objective. The ESCB will consist of a new central institution, the European Central Bank (ECB) and the national central banks, which will be governed by a common set of rules. For the System to operate efficiently and coherently, the Member States are obliged to ensure that national legislation, including the statutes of each national central bank, are compatible with the Treaty and the Statute of the ECB.

The System will be governed by the decision-making bodies of the ECB, the Governing Council and the Executive Board. The Governing Council will be the supreme decision-making body on all matters relating to the ESCB's tasks and operations. It will comprise the President, Vice-President, the other four members of the Executive Board and the Governors of the national central banks. In turn the Executive Board will be entrusted with the day-to-day implementation of monetary policy in accordance with the guidelines and decisions laid down by the Governing Council. To the extent deemed possible and appropriate, the ECB shall have recourse to the national central banks to carry out these operations.

This structure meets two essential requirements. On the one hand, it allows monetary policy decisions to be placed firmly in the hands of the central decision-making body. On the other hand, it offers the possibility of executing policy decisions through the national central banks .

1.3 Independence and democratic accountability of the System

In order for the System to maintain price stability it is important that the decision-making authorities shall not be influenced by considerations which would conflict with this aim. In consequence the Statute states that the ECB, the national central banks and any member of their decision-making bodies shall act without receiving instructions from political authorities. The favourable experience with independent monetary authorities in a number of countries is particularly relevant for a plural Community society where competing interests may tend to give greater thought to short-term considerations and thus lead to pressures in favour of a monetary policy stance which would not always be compatible with price stability in the longer run.

The Statute contains a number of provisions to give practical effect to the principle of independence. Firstly, it ensures that members of the decision-making bodies can exercise their functions under assured tenure. Secondly, the functional, operational and financial provisions guarantee the economic independence of the System. Finally, the principle of "one person, one vote" in the Governing Council also constitutes an element of independence, since it reflects the consensus that members act on behalf of the System rather than as representatives of the Member States.

While independence is considered to be an essential prerequisite for the fulfilment of the System's tasks, it is also fully recognised in

the Statute that there must be democratic legitimacy and accountability. The Statute, which as part of the Treaty on European Union will have to be ratified by the Member States, clearly defines the powers entrusted to the Governing Council and the Executive Board, and the scope of their responsibilities. In addition, the President, Vice-President and other members of the Executive Board 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 Council (of Ministers of Finance and Economic Affairs - the ECOFIN Council) after consulting the European Parliament and the Governing Council. The central bank Governors continue to be appointed by the competent national authorities, but the term of office of a Governor of a national central bank shall be no less than five years.

Transparency is an important element of democratic accountability. In addition to regular reports on the operation of the System and the publication of weekly consolidated financial statements, the ECB will present annual reports to the European Council, the ECOFIN Council, the Commission and the European Parliament. Transparency is further enhanced by the provision that the President of the ECOFIN Council and a member of the Commission may participate, without having the right to vote, in meetings of the Governing Council.

1.4 Operational and functional aspects

To ensure the efficient operation of monetary policy, the Statute provides the System with the powers to select and utilise the necessary instruments and techniques of monetary control. The relevant provisions have been drafted with due regard to the evolutionary nature of financial markets and will allow the System to respond flexibly to changing market conditions.

To avoid any obligation for the System which would render it extremely difficult, if not impossible, to attain price stability, the Statute denies the ECB and the national central banks the possibility of providing overdrafts or other types of credit facilities to public entities.

In the field of exchange rate policy, the ESCB has been entrusted with the task of holding and managing the official reserves of the Member States and of conducting foreign exchange operations. This task must be exercised consistently with the provisions of the Treaty. The ECOFIN

Council may "conclude formal agreements on an exchange rate system for the ECU vis-à-vis non-Community currencies", or, in the absence of such a system, may "formulate general orientations for exchange rate policy". A number of safeguards have been introduced to avoid possible conflicts between measures taken or views expressed by the ECOFIN Council and the operation of monetary policy by the ESCB. In particular, when concluding formal exchange rate "agreements" the Council must consult the ECB "in an endeavour to reach a consensus consistent with the objective of price stability", while "general orientations" for exchange rate policy "shall be without prejudice to the primary objective of the ESCB to maintain price stability".

The System has also been assigned the task of promoting the smooth operation of payment systems. In relation to the wider goal of preserving financial stability in the Community, the ESCB "shall contribute as necessary 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". Furthermore, the ECB has been provided with an advisory role on any proposed Community or national legislation within its field of competence.

1.5 Transitional aspects

The ESCB will be established immediately after the date has been set for the start of Stage Three, or by mid-1998 at the latest. In the event that some Member States do not fulfil the conditions for moving to the final stage they will be granted a derogation; protocols relating to Denmark and the United Kingdom make similar provisions should a decision be taken by either of these countries not to enter the final stage of EMU. Participation in the ESCB of the national central banks of Member States with a derogation is governed by special provisions in the Statute. These provisions recognise that monetary policy in these Member States remains a national responsibility and, furthermore, that these central banks should not participate in the formulation and execution of the single monetary policy pursued by the ESCB. However, to ensure that co-operation with these central banks is maintained, particularly in view of the need to prepare for their eventual full integration into the System, a further decision-making body of the ECB will be created, the General Council. This Council will be composed of the President and Vice-President of the ECB, and the Governors of the national central banks of all the Member States,

and will perform consultative and advisory functions. It will cease to exist when all Member States of the Community have entered the final stage of EMU.

2. THE EUROPEAN MONETARY INSTITUTE

The EMI will be instrumental in facilitating and organising the transition to the single monetary policy which will come into effect in one step at the start of Stage Three. In preparing the transfer of monetary policy competence to the future ESCB, two aspects have to be taken into consideration. On the one hand, the responsibility for monetary policy will remain with the national authorities of the individual Member States, until the start of Stage Three, and, on the other, at the latest at that moment the conditions and operating procedures required for the conduct of the single monetary policy will have to be firmly in place. For this reason a two-pronged strategy will be followed in the transitional phase: national monetary policies will be co-ordinated even more closely than in the past and, at the same time, a wide range of preparatory work will be undertaken in order to enable the future ESCB to perform its tasks. Obviously, the changes in monetary policy operations which will become applicable in Stage Three must not infringe on national monetary policy autonomy during the transitional phase. However, the need to reach a state of readiness on the eve of Stage Three also implies that preparations will have to be made for the necessary adaptations to instruments and procedures currently used at national levels .

2.1 The tasks of the EMI

The importance of guiding monetary developments towards the introduction of the single monetary policy is clearly recognised in the three basic tasks assigned to the EMI (see Annex IV). Firstly, the EMI is entrusted with strengthening the co-ordination of national monetary policies with a view to ensuring price stability. This primary task, together with certain advisory functions, implies the assumption of the role currently performed by the Committee of Governors, which will be dissolved on the establishment of the EMI. In addition, the EMI will have to facilitate the use of the private ECU and oversee its development, including the smooth functioning of the ECU clearing system.

Secondly, the EMI is called upon to make the preparation required for the conduct of a single monetary policy in Stage Three and for the establishment of the ESCB and the creation of a single currency. To this end, the EMI will have to specify at the latest by the end of 1996 the regulatory, organisation and logistical framework for the ESCB. This will include not only the preparation of the necessary monetary policy instruments and procedures, but also cover such areas as the harmonisation of rules and practices governing the collection, compilation and distribution of the relevant monetary and financial statistics, the promotion of efficient EC cross-border payments and the supervision of the technical preparation of ECU bank notes. Moreover, the EMI may be given additional tasks relating to the preparation of Stage Three.

Thirdly, the EMI has some operational tasks which partly arise from the transfer of the functions of the present European Monetary Co-operation Fund, which will cease to exist at the start of Stage Two. Such tasks include in particular the issuance of official ECUs for the purpose of implementing the EMS Agreement. In addition, the EMI is entitled to hold and manage foreign exchange reserves as an agent for, and at the request of, Community central banks. This latter function, however, is subject to rules to be adopted by the EMI which shall ensure that the EMI's transactions with these reserves do not interfere with the monetary and exchange rate policies of the national authorities and are consistent with the objectives of the EMI and the proper functioning of the ERM.

2.2 The structure of the EMI

The EMI will be a Community body which will have its own legal personality. It will be governed by the Council of the EMI which, in addition to the Governors of the national central banks, will include a President appointed by common accord of the Governments of the Member States at the level of Heads of State or of Government on a recommendation from the Committee of Governors from among persons of recognised standing and professional expertise in monetary or banking matters. The President will prepare and chair the meetings of the Council of the EMI, present the views of the EMI externally and be responsible for the day-to-day management. A Vice-President, chosen from among the central bank governors, will perform these duties in the absence of the President.

The EMI will be an independent body. The Council of the EMI may not seek or take any instructions from Community institutions or bodies or

Governments of Member States. However, since the responsibility for monetary policy remains with the national authorities, it is also recognised that the Governors are the representatives of their institutions. Nevertheless, with respect to their activities on the Council of the EMI, they will act according to their own responsibilities. During Stage Two, each Member State, as appropriate, will have to start the process leading to the independence of its central bank, completing it at the latest by the time of the establishment of the ESCB.

The EMI will have its own financial resources to cover its administrative expenditure. These resources will be paid up at the establishment of the EMI in the form of contributions shared by the Community central banks in accordance with a key reflecting in equal proportions their countries' GDP and population.

The existence of the EMI will end with the establishment of the ECB and it will go into liquidation in accordance with the rules laid down in the EMI Statute.

2.3 Preparatory work in the monetary field for the move to Stages Two and Three of EMU

The Treaty on European Union sets a very ambitious agenda for the institutional, organisation and legal measures which at the latest will have to be specified by the end of 1996, i.e. within less than five years. While the preparatory measures for the conduct of a single monetary policy are explicitly assigned to the EMI, the complexity of the issues involved and the time needed to resolve them makes it prudent not to await the establishment of the EMI on 1st January 1994 but rather to commence preparatory work in some of the relevant areas as soon as possible. For this reason, the Committee of Governors has not only embarked on the work required for setting up the EMI, but has also begun to take the first preparatory steps for laying the foundation for the conduct of the single monetary policy.

PART B

THE ORGANISATIONAL STRUCTURE OF THE COMMITTEE OF GOVERNORS

I. THE CREATION AND THE EVOLVING ROLE OF THE COMMITTEE OF GOVERNORS

The Committee of Governors was created in 1964 by the Council Decision (64/300/EEC) of 8th May 1964 on co-operation between the Central Banks of the Member States of the European Economic Community. The initial tasks of the Committee were: "to hold consultations concerning the general principles and the broad lines of policy of the Central Banks, in particular as regards credit and money and foreign exchange markets, and to exchange information at regular intervals about the most important measures that fall within the competence of the Central Banks, and to examine these measures".

While these original tasks reflected the modest ambitions prevailing at that time with respect to monetary co-operation within the Community, the Committee's role was increased at the end of the 1960s as monetary integration progressed and plans to create an economic and monetary union were first launched.¹

In 1971, the Community Central Banks were invited to co-ordinate their policies in monetary and credit matters within the Committee of Governors.² The Committee also became a vehicle for central bank co-operation in the balance-of-payments and exchange rate fields. In 1970, the Community central banks set up the system of short-term monetary support,³ a multilateral credit system giving access to short-term funds in case of a temporary balance-of-payments deficit due to unforeseen difficulties or to conjunctural divergences. Another step on the road towards monetary integration was made in 1972 with the establishment of the

1 See the report to the Council and the Commission on the realisation by stages of economic and monetary union in the Community (Werner Report), dated 8th October 1970.

2 See Council Decision (71/142/EEC) of 22nd March 1971 on the strengthening of co-operation between the central banks of the Member States of the European Economic Community.

3 See the Agreement of 9th February 1970 setting up a system of short-term monetary support among the central banks of the Member States of the European Economic Community.

system for the narrowing of the margins of fluctuation between the currencies of the Member States (the so-called "snake").⁴

At the end of the 1970s the Committee's tasks were extended further when the process of economic and monetary integration was revived. In March 1979, the European Monetary System (EMS) was set up to supersede the "snake". The operational procedures were laid down in the central bank Agreement of 13th March 1979,⁵ which since then has served as the institutional framework for central bank co-operation. In 1986, when the EC Treaty was revised in the context of the Single European Act, advisory status with respect to institutional changes in the monetary area was conferred upon the Committee of Governors (Article 102 A). Additional advisory tasks were assigned to the Committee in 1988 with reference to the abolition of restrictions on capital movements under Article 67 of the Treaty. Most recently, the Committee's responsibilities were increased in the context of Stage One of EMU. The mandate of the Committee was revised by the Council in March 1990 and is reproduced in Annex I. The activities of the Committee under this revised mandate were described in Chapter I.

4 Agreement of 10th April 1972 between the central banks of the Member States of the Community on the narrowing of the margins of fluctuation between Community currencies.

5 Agreement of 13th March 1979 between the central banks of the Member States of the European Economic Community laying down the operating procedures for the European Monetary System.

II. THE ORGANISATIONAL STRUCTURE OF THE COMMITTEE OF GOVERNORS

The growing role of the Committee of Governors and the assignment of new tasks have necessitated changes in the Committee's organisational structure from time to time. The present structure was set up at the start of Stage One of EMU in July 1990 (see Chart 10).

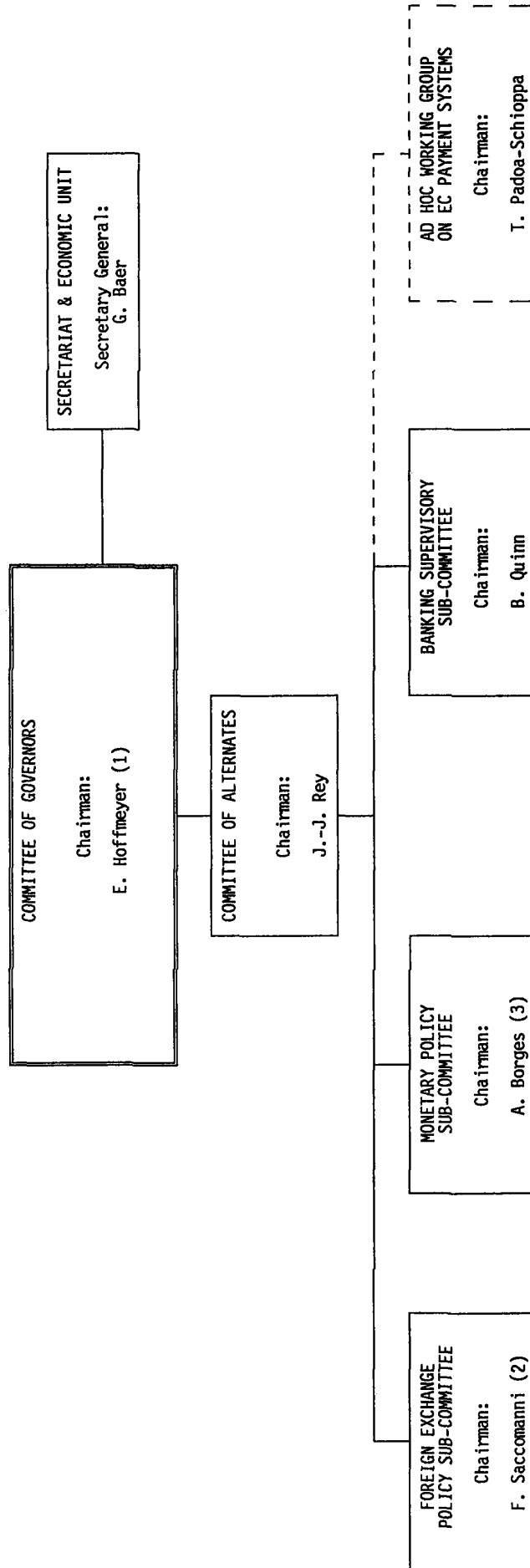
The Committee of Governors is composed of the Governors of the central banks of the Member States of the Community and the Director General of the Luxembourg Monetary Institute. A member of the Commission is regularly invited to the meetings of the Committee. In accordance with the mandate, "the members of the Committee, who are the representatives of their institutions, shall act, with respect to their activities on the Committee, according to their own responsibilities and having due regard to Community objectives".

The Committee of Governors meets at regular intervals, normally ten times a year. The proceedings of the meetings are confidential; however, the Committee may authorise its Chairman to make the outcome of its deliberations public. In the performance of its duties, the Committee enjoys autonomy. It adopts its own rules of procedure and, unlike other Committees created under Community charter, has its own organisational structure. The Chairman is elected by the Committee from among its members. The present Chairman is Dr. E. Hoffmeyer, Governor of Danmarks Nationalbank; he succeeded Herr K.O. Pöhl, who relinquished the chairmanship when resigning as President of the Deutsche Bundesbank at the end of July 1991.

The Committee of Governors is assisted by the Committee of Alternates, three sub-committees, the Secretariat and the Economic Unit. In addition, for specialised tasks, the Committee at times establishes ad hoc working groups. The Chairmen of the sub-committees and working groups are appointed by the Committee of Governors, which also appoints its Secretary General and the other professional members of the Secretariat and Economic Unit. The Commission is in general represented on the various sub-committees and ad hoc working groups.

The Committee of Alternates is composed of senior representatives of Community central banks who have been appointed by the Governors as their alternates in the Committee of Governors. The main task of the Committee of Alternates is to prepare the meetings of the Committee of

CHART 10: ORGANISATION CHART FOR THE COMMITTEE OF GOVERNORS OF THE CENTRAL BANKS OF THE EEC MEMBER STATES (APRIL 1992)



- (1) Replaced K.O. Pöhl with effect from 1st August 1991.
- (2) Replaced H. Dalggaard with effect from 1st September 1991.
- (3) Replaced R. Raymond with effect from 1st September 1991.

Governors on the basis of work carried out by the sub-committees, the Secretariat and the Economic Unit. The Committee of Alternates normally meets on the eve of the Committee of Governors' meetings. The Commission is, as a general rule, invited to send a senior official as a representative to the meetings of the Alternates.

The Foreign Exchange Policy Sub-Committee is composed of central bank officials who are involved in the formulation and implementation of national foreign exchange policies. The Sub-Committee prepares the Governors' discussions on all foreign exchange issues. This preparatory work includes the monthly monitoring of exchange rate and monetary developments, the production of regular reports on the functioning of the EMS and developments in the use of the private ECU, as well as ad hoc studies on special topics. The Sub-Committee also arranges for the regular exchange of information with non-Community central banks in the framework of the "concertation procedure". This procedure provides for the daily exchange of data on exchange market developments, intervention and other official foreign exchange transactions, and for monthly meetings of the "Concertation Group", which is composed of the members of the Sub-Committee and of the Heads of the Foreign Departments of the central banks of the United States, Canada, Japan, Norway, Sweden, Finland, Austria and Switzerland.

The Monetary Policy Sub-Committee is composed of central bank officials who are involved in the formulation and implementation of monetary policies in their national institutions. The duties of the Sub-Committee include the preparation of the regular examinations of monetary policy intentions and their implementation as well as the analysis of issues relating to the conduct of monetary policies in the various stages of EMU. In this context, for instance, it holds consultations on changes in the definition of monetary and credit aggregates in the Community and reviews regularly developments in the field of monetary policy instruments. The Sub-Committee also prepares the Governors' annual assessments of the Member States' budgetary policies and debt management.

The Banking Supervisory Sub-Committee is composed of a senior representative of each Community central bank. In the cases where EEC central banks do not have legal responsibility for banking supervision, a senior representative of the respective banking supervisory authority - namely, the Belgian Banking and Finance Commission, the Danish

Finanstilsynet and the German Bundesaufsichtsamt für das Kreditwesen - also participates in the meetings.

The principal task of the Sub-Committee is to hold regular consultations on matters of common interest relating to the policies and practices of banking supervision in the Member States, particularly where there is a Community-wide dimension. In order to ensure effective co-ordination with other supervisory bodies and to avoid unnecessary duplication in addressing issues of common interest, the Committee liaises with the Basle Committee on Banking Supervision, the Banking Advisory Committee, and the Financial Institutions and Company Law Directorate of the Commission of the European Communities.

For the execution of special tasks, the Committee of Governors has, at times, created ad hoc working groups. At present, issues of direct concern for central banks in the field of payment systems are being studied by such a special working group.

The Secretariat of the Committee of Governors provides all secretarial services to the Committee itself, the Committee of Alternates and the sub-committees, as well as to the Board of Governors of the European Monetary Co-operation Fund (EMCF). In July 1990, an Economic Unit was added to the existing Secretariat. The principal task of the Economic Unit is to provide analytical support to the work of the Committee of Governors.

The Secretariat and the Economic Unit, which are both headed by the Secretary General of the Committee, are independent in their work from any other national or international institution or government. The staff is composed of nationals from the Member States who are in most cases seconded from national central banks or international institutions. The number of staff is currently nineteen.

The Secretariat is based within the Bank for International Settlements, which also provides technical and logistical support to the Committee of Governors. The expenses incurred by the Committee of Governors are shared out among the central banks in proportion to their quotas in the short-term monetary support facility.

ABBREVIATIONS AND SYMBOLS USED IN THE TABLES AND CHARTS¹COUNTRIES²

BE	Belgium
DK	Denmark
DE	Germany
GR	Greece
ES	Spain
FR	France
IR	Ireland
IT	Italy
LU	Luxembourg
NL	Netherlands
PT	Portugal
UK	United Kingdom
US	United States of America
JP	Japan

CURRENCIES

ECU	European Currency Unit
BEF	Belgian/Luxembourg franc
DKK	Danish krone
DEM	Deutsche Mark
GRD	Greek drachma
ESP	Spanish peseta
FRF	French franc
IEP	Irish pound
ITL	Italian lira
NLG	Dutch guilder
PTE	Portuguese escudo
GBP	Pound sterling
USD	US dollar
JPY	Japanese yen

OTHER ABBREVIATIONS

BIS	Bank for International Settlements
EEC	European Economic Community (12 Member States)
ERM	Exchange Rate Mechanism (all EEC Member States participate except Greece and Portugal)
Narrow ERM	Narrow band of the ERM (all EEC Member States participate except Greece, Spain, Portugal and the United Kingdom)
GDP	Gross Domestic Product
GNP	Gross National Product
OECD	Organisation for Economic Co-operation and Development

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- 1 Figures for the EEC, the ERM, and the ERM narrow band are weighted averages.
 - 2 In accordance with Community practice, countries are listed in the Report using the alphabetical order of the national languages, as shown above.

ANNEXES

ANNEX I : Revised mandate of the Committee of Governors

ANNEX II : Harmonisation of broad monetary aggregates

ANNEX III : The Statute of the European System of Central Banks and of the European Central Bank

ANNEX IV : The Statute of the European Monetary Institute

COUNCIL DECISION
of 12th March 1990
amending Council Decision 64/300/EEC on co-operation between the central
banks of the Member States of the European Economic Community

(90/142/EEC)

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community, and in particular to Article 105(1) and to the first indent of Article 145 thereof,

Having regard to the recommendation from the Commission,

Having regard to the opinion of the European Parliament¹,

Having regard to the opinion of the Economic and Social Committee²,

Whereas the European Council, at its meeting in Madrid on 26th and 27th June 1989, decided that the first stage of the realisation of economic and monetary union should begin on 1st July 1990;

Whereas Article 102a of the Treaty together with the realisation of the first stage of the economic and monetary union call for an increased degree of convergence in economic performance towards non-inflationary growth and of economic and social cohesion between the Member States;

Whereas greater convergence should be promoted with a view to achieving domestic price stability, which is at the same time a necessary condition for stable exchange rates, in accordance with the requirements of the European Monetary System;

Whereas the realisation of the first stage of economic and monetary union will focus on completing the internal market and in particular on removing all obstacles to financial integration, on strengthening the process of co-ordination of monetary policies, on intensifying co-operation between central banks on other matters falling within their competence and whereas, in this connection, consideration should be given to extending the scope of the central banks' autonomy;

Whereas arrangements for the formulation of monetary policy within the framework of an economic and monetary union should provide for adequate autonomy for the institutions and for commitment to price stability, which is essential to the success of that union;

Whereas, in view of the objective of the progressive realisation of economic and monetary union, the tasks should be extended and the tasks

1 Official Journal of the European Communities No. C68, 19.3.1990.

2 Official Journal of the European Communities No. C56, 7.3.1990, p.47.

Annex I

and role of the Committee of Governors of the Central Banks of the Member States of the European Economic Community should be reinforced;

Whereas Decision 64/300/EEC³ should be amended in consequence,

HAS DECIDED AS FOLLOWS:

Sole Article

Decision 64/300/EEC is amended as follows:

1. Article 2 is replaced by the following:

"Article 2

The Committee shall be composed of the Governors of the Central Banks of the Member States and the Director-General of the Luxembourg Monetary Institute. If they are unable to attend, they may nominate another representative of their institution.

The Commission shall, as a general rule, be invited to send one of its members as a representative to the meetings of the Committee.

The Committee may, furthermore, if it considers it necessary, invite qualified persons to attend and in particular the chairman of the monetary committee."

2. The following Article is inserted:

"Article 2a

The chairman of the Committee shall be invited to participate in the meetings of the Council of Ministers whenever it deals with issues involving the tasks of the Committee of Governors."

3. Article 3 is replaced by the following:

"Article 3

The tasks of the Committee shall be:

- (1) to hold consultations concerning the general principles and the broad lines of monetary policy, in particular as regards credit, the money and foreign exchange markets as well as issues falling within the competence of the central banks and affecting the stability of financial institutions and markets;
- (2) to exchange information regularly about the most important measures that fall within the competence of the central banks, and to examine those measures. The Committee shall normally be consulted before the national authorities take decisions on the course of monetary policy, such as the setting of annual money supply and credit targets;
- (3) to promote the co-ordination of the monetary policies of the Member States with the aim of achieving price stability as a necessary condition for the proper functioning of the European Monetary System and the realisation of its objective of monetary stability;

3 Official Journal of the European Communities No. 77, 21.5.1964, p.1206/64.

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- (4) to formulate opinions on the overall orientation of monetary and exchange rate policy as well as on the respective measures introduced in individual Member States;
- (5) to express opinions to individual governments and the Council of Ministers on policies which might affect the internal and external monetary situation in the Community and, in particular, the functioning of the European Monetary System.

In carrying out its tasks, the Committee shall keep under review the monetary situation and prospects both inside and outside the Community.

The Committee shall prepare an annual report on its activities and on the monetary and financial conditions in the Community, which will be transmitted to the European Parliament, the Council of Ministers, and the European Council. The President of the Committee may be invited to appear before the European Parliament on this occasion and also before the competent committee of the European Parliament where the circumstances so justify.

The Committee may authorise its chairman to make the outcome of its deliberations public."

4. The following Article is inserted:

"Article 3a

The members of the Committee, who are the representatives of their institutions, shall act, with respect to their activities on the Committee, according to their own responsibilities and having due regard to Community objectives."

5. Article 5 is replaced by the following:

"Article 5

The Committee shall adopt its own rules of procedure. It may set up sub-committees and provide its own secretariat and research services."

Done at Brussels, 12th March 1990.

For the Council

The President

A. REYNOLDS

Annex IIHARMONISATION OF BROAD MONETARY AGGREGATES

Over the last eighteen months, Community central banks and the Economic Unit have worked together to improve the consistency of national definitions of money stocks. The project has initially concentrated on broad money aggregates, which are used as intermediate monetary targets or as a key monetary indicator in most Community countries. Narrow monetary aggregates may be examined more closely at a later stage; however, a preliminary survey has indicated that their definitions are already quite similar across Community countries.

The starting point for the harmonisation project was to select the national measures of broad money which seemed to be closest in statistical content. Even though their names vary,¹ the definitions proved to be already reasonably similar in most cases. In addition to assets included in narrow aggregates (typically those used as an immediate means of payment), broad aggregates generally incorporate other "liquid assets", which are close substitutes for a means of payment either because they have a short maturity or because they can be easily transformed into a means of payment at little cost or risk of loss.

Certain discrepancies were identified, however, in the asset composition and in other aspects, such as currency denomination, of the national definitions. Nevertheless, given the differences in financial structure and behaviour across Community countries, it was felt that full harmonisation, in the sense of a mechanical elimination of all statistical discrepancies, would have been inappropriate. Rather, the characteristics of assets which are, or could be, included in national definitions had to be examined carefully on a case-by-case basis in order to assess their relevance in practice. Furthermore, due regard had to be paid to the need to preserve the economic properties which render monetary aggregates useful in the conduct of monetary policy. Among these properties, priority was given to the stability of the link between money and the final goals. The importance of controllability was less clear, since the process of European financial integration, together with the objective of exchange rate stability, is gradually weakening the scope to control monetary growth at the national level.

The economic properties of the broad aggregates chosen as a starting point for the harmonisation exercise served as benchmarks when assessing alternative statistical definitions. Econometric analysis showed that for most countries the selected definitions have exhibited a fairly stable and predictable link with nominal income and interest rates over the 1980s.

Following economic and statistical analysis of possible alternatives for national aggregates, recommendations for changes in definition have been put forward. In some cases, they are being embodied in official national definitions; in others, for the time being, they will only be implemented for the internal purposes of the Committee of Governors, as further analysis may be needed. Once the proposed changes have been implemented, the definitions of broad money will be sufficiently similar across the Community - in terms of asset composition, currency denomination and sectoral definition - to facilitate both the direct

1 Aggregates selected were M3 in Belgium, Germany, France, the Netherlands, Greece and Ireland, M2 in Italy, Denmark and Luxembourg, M4 in the United Kingdom, ALP in Spain, and L in Portugal.

Annex II

comparison of developments in national money stocks and the aggregation of the latter into monetary indicators for the area as a whole.

After harmonisation, the aggregates under review display the following characteristics:

(a) Asset composition

The aggregates include the following monetary assets: notes, coins and sight deposits, as well as savings deposits, deposits at notice and fixed-time deposits, except those above certain maturity thresholds in a few countries. This latter difference is relatively minor in practice since, in the countries where thresholds are not used, assets are mostly short-term, and, where thresholds are used, the excluded assets have obvious non-monetary features, such as a very long maturity or a high cost of conversion into a liquid asset. Criteria based on the notions of liquidity and substitutability with other assets were applied to assess the desirability of including such assets as negotiable certificates, repurchase agreements between banks and non-banks (irrespective of the asset used as collateral), short-term bank bonds, and non-negotiable certificates.

(b) Currency denomination and cross-border holdings

To comply with the current practice of most Community countries, monetary aggregates should include assets, held by domestic residents, independently of whether they are denominated in domestic or foreign currency. Data on holdings of those assets are readily available when they are the liabilities of domestically-located intermediaries. However, given the increasing importance of cross-border holdings by non-financial residents, "extended national measures" which include these holdings will be used as auxiliary indicators according to the availability of statistical information.

(c) Sectoral definition

As long as financial structures and behaviour differ, the sectoral definition of money "issuers" and "holders" across the Community should take country-specific features into account. As a result, no common definition of these sectors can be put forward. However, as a general principle, all monetary liabilities of the (domestically-located) financial institutions which operate as banks should be included. The resulting aggregate is taken as the principal monetary indicator and, at present, is termed "M3H" for the internal purposes of the Committee of Governors. A wider concept, called internally "M4H", is also monitored. In addition to the instruments included in M3H, this broader concept consists of those liabilities of the non-financial sector which are highly substitutable for the components of M3H (mainly Government short-term paper and corporate commercial paper).

Annex III

TREATY ON EUROPEAN UNION
AS SIGNED ON 7TH FEBRUARY 1992

PROTOCOL
ON THE STATUTE OF THE EUROPEAN SYSTEM OF CENTRAL BANKS
AND OF THE EUROPEAN CENTRAL BANK

THE HIGH CONTRACTING PARTIES,

DESIRING to lay down the Statute of the European System of Central Banks and of the European Central Bank provided for in Article 4a of the Treaty establishing the European Community,

HAVE AGREED upon the following provisions, which shall be annexed to the Treaty establishing the European Community:

CHAPTER I - CONSTITUTION OF THE ESCB

ARTICLE 1 - The European System of Central Banks

1.1 The European System of Central Banks (ESCB) and the European Central Bank (ECB) shall be established in accordance with Article 4a of this Treaty; they shall perform their tasks and carry on their activities in accordance with the provisions of this Treaty and of this Statute.

1.2 In accordance with Article 106(1) of this Treaty, the ESCB shall be composed of the ECB and of the central banks of the Member States ("national central banks"). The Institut monétaire luxembourgeois will be the central bank of Luxembourg.

CHAPTER II - OBJECTIVES AND TASKS OF THE ESCB

ARTICLE 2 - Objectives

In accordance with Article 105(1) of this Treaty, the primary objective of the ESCB shall be to maintain price stability.

Without prejudice to the objective of price stability, it 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 of this Treaty.

The ESCB shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 3a of this Treaty.

ARTICLE 3 - Tasks

3.1 In accordance with Article 105(2) of this Treaty, the basic tasks to be carried out through the ESCB shall be:

- to define and implement the monetary policy of the Community;
- to conduct foreign exchange operations consistent with the provisions of Article 109 of this Treaty;
- to hold and manage the official foreign reserves of the Member States;
- to promote the smooth operation of payment systems.

Annex III

3.2 In accordance with Article 105(3) of this Treaty, the third indent of Article 3.1 shall be without prejudice to the holding and management by the governments of Member States of foreign exchange working balances.

3.3 In accordance with Article 105(5) of this Treaty, the ESCB shall contribute 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.

ARTICLE 4 - Advisory functions

In accordance with Article 105(4) of this Treaty:

- a) the ECB shall be consulted:
 - on any proposed Community act in its fields of competence;
 - by national authorities regarding any draft legislative provision in its fields of competence, but within the limits and under the conditions set out by the Council in accordance with the procedure laid down in Article 42;
- b) the ECB may submit opinions to the appropriate Community institutions or bodies or to national authorities on matters in its fields of competence.

ARTICLE 5 - Collection of statistical information

5.1 In order to undertake the tasks of the ESCB, the ECB, assisted by the national central banks, shall collect the necessary statistical information either from the competent national authorities or directly from economic agents. For these purposes it shall co-operate with the Community institutions or bodies and with the competent authorities of the Member States or third countries and with international organisations.

5.2 The national central banks shall carry out, to the extent possible, the tasks described in Article 5.1.

5.3 The ECB shall contribute to the harmonisation, where necessary, of the rules and practices governing the collection, compilation and distribution of statistics in the areas within its fields of competence.

5.4 The Council, in accordance with the procedure laid down in Article 42, shall define the natural and legal persons subject to reporting requirements, the confidentiality regime and the appropriate provisions for enforcement.

ARTICLE 6 - International co-operation

6.1 In the field of international co-operation involving the tasks entrusted to the ESCB, the ECB shall decide how the ESCB shall be represented.

6.2 The ECB and, subject to its approval, the national central banks may participate in international monetary institutions.

6.3 Articles 6.1 and 6.2 shall be without prejudice to Article 109(4) of this Treaty.

CHAPTER III - ORGANISATION OF THE ESCB**ARTICLE 7 - Independence**

In accordance with Article 107 of this Treaty, when exercising the powers and carrying out the tasks and duties conferred upon them by this Treaty and this Statute, 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 or 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 members of the decision-making bodies of the ECB or of the national central banks in the performance of their tasks.

ARTICLE 8 - General principle

The ESCB shall be governed by the decision-making bodies of the ECB.

ARTICLE 9 - The European Central Bank

9.1 The ECB which, in accordance with Article 106(2) of this Treaty, shall have legal personality, shall enjoy in each of the Member States the most extensive legal capacity accorded to legal persons under its law; it may, in particular, acquire or dispose of movable and immovable property and may be a party to legal proceedings.

9.2 The ECB shall ensure that the tasks conferred upon the ESCB under Article 105(2), (3) and (5) of this Treaty are implemented either by its own activities pursuant to this Statute or through the national central banks pursuant to Articles 12.1 and 14.

9.3 In accordance with Article 106(3) of this Treaty, the decision-making bodies of the ECB shall be the Governing Council and the Executive Board.

ARTICLE 10 - The Governing Council

10.1 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.

10.2 Subject to Article 10.3, only members of the Governing Council present in person shall have the right to vote. By way of derogation from this rule, the Rules of Procedure referred to in Article 12.3 may lay down that members of the Governing Council may cast their vote by means of teleconferencing. These rules shall also provide that a member of the Governing Council who is prevented from voting for a prolonged period may appoint an alternate as a member of the Governing Council.

Subject to Articles 10.3 and 11.3, each member of the Governing Council shall have one vote. Save as otherwise provided for in this Statute, the Governing Council shall act by a simple majority. In the event of a tie, the President shall have the casting vote.

In order for the Governing Council to vote, there shall be a quorum of two-thirds of the members. If the quorum is not met, the President may convene an extraordinary meeting at which decisions may be taken without regard to the quorum.

Annex III

10.3 For any decisions to be taken under Articles 28, 29, 30, 32, 33 and 51, the votes in the Governing Council shall be weighted according to the national central banks' shares in the subscribed capital of the ECB. The weights of the votes of the members of the Executive Board shall be zero. A decision requiring a qualified majority shall be adopted if the votes cast in favour represent at least two-thirds of the subscribed capital of the ECB and represent at least half of the shareholders. If a Governor is unable to be present, he may nominate an alternate to cast his weighted vote.

10.4 The proceedings of the meetings shall be confidential. The Governing Council may decide to make the outcome of its deliberations public.

10.5 The Governing Council shall meet at least ten times a year.

ARTICLE 11 - The Executive Board

11.1 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 members shall perform their duties on a full-time basis. No member shall engage in any occupation, whether gainful or not, unless exemption is exceptionally granted by the Governing Council.

11.2 In accordance with Article 109a(2)(b) of this Treaty, the President, the Vice-President and the other Members of the Executive Board shall be appointed from among persons of recognised standing and professional experience in monetary or banking matters by common accord of the governments of the Member States at the level of the Heads of State or of Government, on a recommendation from the Council after it has consulted the European Parliament and the Governing Council.

Their term of office shall be eight years and shall not be renewable.

Only nationals of Member States may be members of the Executive Board.

11.3 The terms and conditions of employment of the members of the Executive Board, in particular their salaries, pensions and other social security benefits shall be the subject of contracts with the ECB and shall be fixed by the Governing Council on a proposal from the Committee comprising three members appointed by the Governing Council and three members appointed by the Council. The members of the Executive Board shall not have the right to vote on matters referred to in this paragraph.

11.4 If a member of the Executive Board no longer fulfils the conditions required for the performance of his duties or if he has been guilty of serious misconduct, the Court of Justice may, on application by the Governing Council or the Executive Board, compulsorily retire him.

11.5 Each member of the Executive Board present in person shall have the right to vote and shall have, for that purpose, one vote. Save as otherwise provided, the Executive Board shall act by a simple majority of the votes cast. In the event of a tie, the President shall have the casting vote. The voting arrangements shall be specified in the Rules of Procedure referred to in Article 12.3.

11.6 The Executive Board shall be responsible for the current business of the ECB.

Annex III

11.7 Any vacancy on the Executive Board shall be filled by the appointment of a new member in accordance with Article 11.2.

ARTICLE 12 - Responsibilities of the decision-making bodies

12.1 The Governing Council shall adopt the guidelines and take the decisions necessary to ensure the performance of the tasks entrusted to the ESCB under this Treaty and this Statute. The Governing Council shall 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 shall establish the necessary guidelines for their implementation.

The Executive Board shall implement monetary policy in accordance with the guidelines and decisions laid down by the Governing Council. In doing so the Executive Board shall give the necessary instructions to national central banks. In addition the Executive Board may have certain powers delegated to it where the Governing Council so decides.

To the extent deemed possible and appropriate and without prejudice to the provisions of this Article, the ECB shall have recourse to the national central banks to carry out operations which form part of the tasks of the ESCB.

12.2 The Executive Board shall have responsibility for the preparation of meetings of the Governing Council.

12.3 The Governing Council shall adopt Rules of Procedure which determine the internal organisation of the ECB and its decision-making bodies.

12.4 The Governing Council shall exercise the advisory functions referred to in Article 4.

12.5 The Governing Council shall take the decisions referred to in Article 6.

ARTICLE 13 - The President

13.1 The President or, in his absence, the Vice-President shall chair the Governing Council and the Executive Board of the ECB.

13.2 Without prejudice to Article 39, the President or his nominee shall represent the ECB externally.

ARTICLE 14 - National central banks

14.1 In accordance with Article 108 of this Treaty, each Member State shall ensure, at the latest at the date of the establishment of the ESCB, that its national legislation, including the statutes of its national central bank, is compatible with this Treaty and this Statute.

14.2 The statutes of the national central banks shall, in particular, provide that the term of office of a Governor of a national central bank shall be no less than 5 years.

A Governor may be relieved from office only if he no longer fulfils the conditions required for the performance of his duties or if he has been guilty of serious misconduct.

A decision to this effect may be referred to the Court of Justice by the Governor concerned or the Governing Council on grounds of infringement of this Treaty or of any rule of law relating to its application. Such proceedings shall be instituted within two months of the

Annex III

publication of the decision or of its notification to the plaintiff or, in the absence thereof, of the day on which it came to the knowledge of the latter, as the case may be.

14.3 The national central banks are an integral part of the ESCB and shall act in accordance with the guidelines and instructions of the ECB. The Governing Council shall take the necessary steps to ensure compliance with the guidelines and instructions of the ECB, and shall require that any necessary information be given to it.

14.4 National central banks may perform functions other than those specified in this Statute unless the Governing Council finds, by a majority of two thirds of the votes cast, that these interfere with the objectives and tasks of the ESCB. Such functions shall be performed on the responsibility and liability of national central banks and shall not be regarded as being part of the functions of the ESCB.

ARTICLE 15 - Reporting commitments

15.1 The ECB shall draw up and publish reports on the activities of the ESCB at least quarterly.

15.2 A consolidated financial statement of the ESCB shall be published each week.

15.3 In accordance with Article 109b(3) of this Treaty, the ECB shall address an annual report on the activities of the ESCB and on the monetary policy of both the previous and the current year to the European Parliament, the Council and the Commission, and also to the European Council.

15.4 The reports and statements referred to in this Article shall be made available to interested parties free of charge.

ARTICLE 16 - Bank notes

In accordance with Article 105a(1) of this Treaty, the Governing Council shall have the exclusive right to authorise the issue of bank notes within the Community.

The ECB and the national central banks may issue such notes. The bank notes issued by the ECB and the national central banks shall be the only such notes to have the status of legal tender within the Community.

The ECB shall respect as far as possible existing practices regarding the issue and design of bank notes.

CHAPTER IV - MONETARY FUNCTIONS AND OPERATIONS OF THE ESCB**ARTICLE 17 - Accounts with the ECB and the national central banks**

In order to conduct their operations, the ECB and the national central banks may open accounts for credit institutions, public entities and other market participants and accept assets, including book-entry securities, as collateral.

ARTICLE 18 - Open market and credit operations

18.1 In order to achieve the objectives of the ESCB and to carry out its tasks, the ECB and the national central banks may:

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- operate in the financial markets by buying and selling outright (spot and forward) or under repurchase agreement and by lending or borrowing claims and marketable instruments, whether in Community or in non-Community currencies, as well as precious metals;
- conduct credit operations with credit institutions and other market participants, with lending being based on adequate collateral.

18.2 The ECB shall establish general principles for open market and credit operations carried out by itself or the national central banks, including for the announcement of conditions under which they stand ready to enter into such transactions.

ARTICLE 19 - Minimum reserves

19.1 Subject to Article 2, the ECB may require credit institutions established in Member States to hold minimum reserves on accounts with the ECB and national central banks in pursuance of monetary policy objectives. Regulations concerning the calculation and determination of the required minimum reserves may be established by the Governing Council. In cases of non-compliance the ECB shall be entitled to levy penalty interest and to impose other sanctions with comparable effect.

19.2 For the application of this Article, the Council shall, in accordance with the procedure laid down in Article 42, define the basis for minimum reserves and the maximum permissible ratios between those reserves and their basis, as well as the appropriate sanctions in cases of non-compliance.

ARTICLE 20 - Other instruments of monetary control

The Governing Council may, by a majority of two thirds of the votes cast, decide upon the use of such other operational methods of monetary control as it sees fit, respecting Article 2.

The Council shall, in accordance with the procedure laid down in Article 42, define the scope of such methods if they impose obligations on third parties.

ARTICLE 21 - Operations with public entities

21.1 In accordance with Article 104 of this Treaty, overdrafts or any other type of credit facility with the ECB or with the national central banks in favour of Community institutions or bodies, central governments, regional, local or other public authorities, other bodies governed by public law or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the ECB or national central banks of debt instruments.

21.2 The ECB and national central banks may act as fiscal agents for the entities referred to in Article 21.1.

21.3 The provisions of this Article shall not apply to publicly-owned credit institutions which, in the context of the supply of reserves by central banks, shall be given the same treatment by national central banks and the ECB as private credit institutions.

Annex III**ARTICLE 22 - Clearing and payment systems**

The ECB and national central banks may provide facilities, and the ECB may issue regulations, to ensure efficient and sound clearing and payment systems within the Community and with other countries.

ARTICLE 23 - External operations

The ECB and national central banks may:

- establish relations with central banks and financial institutions in other countries and, where appropriate, with international organisations;
- acquire and sell spot and forward all types of foreign exchange assets and precious metals; the term "foreign exchange asset" shall include securities and all other assets in the currency of any country or units of account and in whatever form held;
- hold and manage the assets referred to in this Article;
- conduct all types of banking transactions in relations with third countries and international organisations, including borrowing and lending operations.

ARTICLE 24 - Other operations

In addition to operations arising from their tasks, the ECB and the national central banks may enter into operations for their administrative purposes or for their staff.

CHAPTER V - PRUDENTIAL SUPERVISION**ARTICLE 25 - Prudential supervision**

25.1 The ECB may offer advice to and be consulted by the Council, the Commission and the competent authorities of the Member States on the scope and implementation of Community legislation relating to the prudential supervision of credit institutions and to the stability of the financial system.

25.2 In accordance with any decision of the Council under Article 105(6) of this Treaty, the ECB may perform specific tasks concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings.

CHAPTER VI - FINANCIAL PROVISIONS OF THE ESCB**ARTICLE 26 - Financial accounts**

26.1 The financial year of the ECB and the national central banks shall begin on the first day of January and end on the last day of December.

26.2 The annual accounts of the ECB shall be drawn up by the Executive Board, in accordance with the principles established by the Governing Council.

The accounts shall be approved by the Governing Council and shall thereafter be published.

26.3 For analytical and operational purposes, the Executive Board shall draw up a consolidated balance sheet of the ESCB, comprising those

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assets and liabilities of the national central banks that fall within the ESCB.

26.4 For the application of this Article, the Governing Council shall establish the necessary rules for standardising the accounting and reporting of operations undertaken by the national central banks.

ARTICLE 27 - Auditing

27.1 The accounts of the ECB and national central banks shall be audited by independent external auditors recommended by the Governing Council and approved by the Council.

The auditors shall have full power to examine all books and accounts of the ECB and national central banks and obtain full information about their transactions.

27.2 The provisions of Article 188b of this Treaty shall only apply to an examination of the operational efficiency of the management of the ECB.

ARTICLE 28 - Capital of the ECB

28.1 The capital of the ECB, which shall become operational upon its establishment, shall be ECU 5,000 million.

The capital may be increased by such amounts as may be decided by the Governing Council acting by the qualified majority provided for in Article 10.3, within the limits and under the conditions set by the Council under the procedure laid down in Article 42.

28.2 The national central banks shall be the sole subscribers to and holders of the capital of the ECB. The subscription of capital shall be according to the key established in accordance with Article 29.

28.3 The Governing Council, acting by the qualified majority provided for in Article 10.3, shall determine the extent to which and the form in which the capital shall be paid up.

28.4 Subject to Article 28.5, the shares of the national central banks in the subscribed capital of the ECB may not be transferred, pledged or attached.

28.5 If the key referred to in Article 29 is adjusted, the national central banks shall transfer among themselves capital shares to the extent necessary to ensure that the distribution of capital shares corresponds to the adjusted key.

The Governing Council shall determine the terms and conditions of such transfers.

ARTICLE 29 - Key for capital subscription

29.1 When in accordance with the procedure referred to in Article 109l(1) of this Treaty the ESCB and the ECB have been established, the key for subscription of the ECB's capital shall be established. Each national central bank shall be assigned a weighting in this key which shall be equal to the sum of:

- 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;
- 50% of the share of its respective Member State in the gross domestic product at market prices of the Community as recorded

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in the last five years preceding the penultimate year before the establishment of the ESCB;

The percentages shall be rounded up to the nearest multiple of 0.05% points.

29.2 The statistical data to be used for the application of this Article shall be provided by the Commission in accordance with the rules adopted by the Council under the procedure provided for in Article 42.

29.3 The weightings assigned to the national central banks shall be adjusted every five years after the establishment of the ESCB by analogy with the provisions laid down in Article 29.1.

The adjusted key shall apply with effect from the first day of the following year.

29.4 The Governing Council shall take all other measures necessary for the application of this Article.

ARTICLE 30 - Transfer of foreign reserve assets to the ECB

30.1 Without prejudice to Article 28, the ECB shall be provided by the national central banks with foreign reserve assets, other than Member States' currencies, ECUs, IMF reserve positions and SDRs, up to an amount equivalent to ECU 50,000 million. The Governing Council shall decide upon the proportion to be called up by the ECB following its establishment and the amounts called up at later dates.

The ECB shall have the full right to hold and manage the foreign reserves that are transferred to it and to use them for the purposes set out in this Statute.

30.2 The contributions of each national central bank shall be fixed in proportion to its share in the subscribed capital of the ECB.

30.3 Each national central bank shall be credited by the ECB with a claim equivalent to its contribution.

The Governing Council shall determine the denomination and remuneration of such claims.

30.4 Further calls of foreign reserve assets beyond the limit set in Article 30.1 may be effected by the ECB, in accordance with Article 30.2, within the limits and under the conditions set by the Council in accordance with the procedure laid down in Article 42.

30.5 The ECB may hold and manage IMF reserve positions and SDRs and provide for the pooling of such assets.

30.6 The Governing Council shall take all other measures necessary for the application of this Article.

ARTICLE 31 - Foreign reserve assets held by national central banks

31.1 The national central banks shall be allowed to perform transactions in fulfilment of their obligations towards international organisations in accordance with Article 23.

31.2 All other operations in foreign reserve assets remaining with the national central banks after the transfers referred to in Article 30, and Member States' transactions with their foreign exchange working balances shall, above a certain limit to be established within the framework of Article 31.3, be subject to approval by the ECB in order to

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ensure consistency with the exchange rate and monetary policies of the Community.

31.3 The Governing Council shall issue guidelines with a view to facilitating such operations.

ARTICLE 32 - Allocation of monetary income of national central banks

32.1 The income accruing to the national central banks in the performance of the ESCB's monetary policy function (hereinafter referred to as "monetary income") shall be allocated at the end of each financial year in accordance with the provisions of this Article.

32.2 Subject to Article 32.3, the amount of each national central bank's monetary income shall be equal to its annual income derived from its assets held against notes in circulation and deposit liabilities to credit institutions. These assets shall be earmarked by national central banks in accordance with guidelines to be established by the Governing Council.

32.3 If, after the start of the third stage, the balance sheet structures of the national central banks do not, in the judgement of the Governing Council, permit the application of Article 32.2, the Governing Council, acting by a qualified majority, may decide that, by way of derogation from Article 32.2, monetary income shall be measured according to an alternative method for a period of not more than five years.

32.4 The amount of each national central bank's monetary income shall be reduced by an amount equivalent to any interest paid by that central bank on its deposit liabilities to credit institutions in accordance with Article 19.

The Governing Council may decide that national central banks shall be indemnified against costs incurred in connection with the issue of bank notes or in exceptional circumstances for specific losses arising from monetary policy operations undertaken for the ESCB.

Indemnification shall be in a form deemed appropriate in the judgement of the Governing Council; these amounts may be offset against the national central banks' monetary income.

32.5 The sum of the national central banks' monetary income shall be allocated to the national central banks in proportion to their paid-up shares in the capital of the ECB, subject to any decision taken by the Governing Council pursuant to Article 33.2.

32.6 The clearing and settlement of the balances arising from the allocation of monetary income shall be carried out by the ECB in accordance with guidelines established by the Governing Council.

32.7 The Governing Council shall take all other measures necessary for the application of this Article.

ARTICLE 33 - Allocation of net profits and losses of the ECB

33.1 The net profit of the ECB shall be transferred in the following order:

- (a) an amount to be determined by the Governing Council, which may not exceed 20% of the net profit, shall be transferred to the general reserve fund subject to a limit equal to 100% of the capital;
- (b) the remaining net profit shall be distributed to the shareholders of the ECB in proportion to their paid-up shares.

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33.2 In the event of a loss incurred by the ECB, the shortfall may be offset against the general reserve fund of the ECB and, if necessary, following a decision by the Governing Council, against the monetary income of the relevant financial year in proportion and up to the amounts allocated to the national central banks in accordance with Article 32.5.

CHAPTER VII - GENERAL PROVISIONS**ARTICLE 34 - Legal acts**

- 34.1 In accordance with Article 108a of this Treaty, the ECB shall:
- make regulations to the extent necessary to implement the tasks defined in Article 3.1, first indent, Articles 19.1, 22 or 25.2 and in cases which shall be laid down in the acts of the Council referred to in Article 42;
 - take decisions necessary for carrying out the tasks entrusted to the ESCB under this Treaty and this Statute;
 - make recommendations and deliver opinions.

34.2 A regulation shall have general application. It shall be binding in its entirety and directly applicable in all Member States.

Recommendations and opinions shall have no binding force.

A decision shall be binding in its entirety upon those to whom it is addressed.

Articles 190 to 192 of this Treaty shall apply to regulations and decisions adopted by the ECB.

The ECB may decide to publish its decisions, recommendations and opinions.

34.3 Within the limits and under the conditions adopted by the Council under the procedure laid down in Article 42, the ECB shall be entitled to impose fines or periodic penalty payments on undertakings for failure to comply with obligations under its regulations and decisions.

ARTICLE 35 - Judicial control and related matters

35.1 The acts or omissions of the ECB shall be open to review or interpretation by the Court of Justice in the cases and under the conditions laid down in this Treaty.

The ECB may institute proceedings in the cases and under the conditions laid down in this Treaty.

35.2 Disputes between the ECB, on the one hand, and its creditors, debtors or any other person, on the other, shall be decided by the competent national courts, save where jurisdiction has been conferred upon the Court of Justice.

35.3 The ECB shall be subject to the liability regime provided for in Article 215 of this Treaty.

The national central banks shall be liable according to their respective national laws.

35.4 The Court of Justice shall have jurisdiction to give judgement pursuant to any arbitration clause contained in a contract concluded by or on behalf of the ECB, whether that contract be governed by public or private law.

35.5 A decision of the ECB to bring an action before the Court of Justice shall be taken by the Governing Council.

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35.6 The Court of Justice shall have jurisdiction in disputes concerning the fulfilment by a national central bank of obligations under this Statute.

If the ECB considers that a national central bank has failed to fulfil an obligation under this Statute, it shall deliver a reasoned opinion on the matter after giving the national central bank concerned the opportunity to submit its observations.

If the national central bank concerned does not comply with the opinion within the period laid down by the ECB, the latter may bring the matter before the Court of Justice.

ARTICLE 36 - Staff

36.1 The Governing Council, on a proposal from the Executive Board, shall lay down the conditions of employment of the staff of the ECB.

36.2 The Court of Justice shall have jurisdiction in any dispute between the ECB and its servants within the limits and under the conditions laid down in the conditions of employment.

ARTICLE 37 - Seat

Before the end of 1992, the decision as to where the seat of the ECB will be established shall be taken by common accord of the governments of the Member States at the level of Heads of State or of Government.

ARTICLE 38 - Professional secrecy

38.1 Members of the governing bodies and the staff of the ECB and the national central banks shall be required, even after their duties have ceased, not to disclose information of the kind covered by the obligation of professional secrecy.

38.2 Persons having access to data covered by Community legislation imposing an obligation of secrecy shall be subject to such legislation.

ARTICLE 39 - Signatories

The ECB shall be legally committed to third parties by the President or by two members of the Executive Board or by the signatures of two members of the staff of the ECB who have been duly authorised by the President to sign on behalf of the ECB.

ARTICLE 40 - Privileges and immunities

The ECB shall enjoy in the territories of the Member States such privileges and immunities as are necessary for the performance of its tasks, under the conditions laid down in the Protocol on the Privileges and Immunities of the European Communities annexed to the Treaty establishing a Single Council and a Single Commission of the European Communities.

CHAPTER VIII - AMENDMENT OF THE STATUTE AND COMPLEMENTARY LEGISLATION**ARTICLE 41 - Simplified amendment procedure**

41.1 In accordance with Article 106(5) of this Treaty, Articles 5.1, 5.2, 5.3, 17, 18, 19.1, 22, 23, 24, 26, 32.2, 32.3, 32.4, 32.6, 33.1(a) and 36 of this Statute may be amended by the Council, acting either by a qualified majority on a recommendation from the ECB and after consulting

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the Commission, or unanimously on a proposal from the Commission and after consulting the ECB. In either case the assent of the European Parliament shall be required.

41.2 A recommendation made by the ECB under this Article shall require a unanimous decision by the Governing Council.

ARTICLE 42 - Complementary legislation

In accordance with Article 106(6) of this Treaty, immediately after the decision on the date for the beginning of the third stage, the Council, acting by a qualified majority either on a proposal from the Commission and after consulting the European Parliament and the ECB, or on a recommendation from the ECB and after consulting the European Parliament and the Commission, shall adopt the provisions referred to in Articles 4, 5.4, 19.2, 20, 28.1, 29.2, 30.4 and 34.3 of this Statute.

CHAPTER IX - TRANSITIONAL AND OTHER PROVISIONS FOR THE ESCB**ARTICLE 43 - General provisions**

43.1 A derogation as referred to in Article 109k(1) of this Treaty shall entail that the following Articles of this Statute shall not confer any rights or impose any obligations on the Member State concerned: 3, 6, 9.2, 12.1, 14.3, 16, 18, 19, 20, 22, 23, 26.2, 27, 30, 31, 32, 33, 34, 50 and 52.

43.2 The central banks of Member States with a derogation as specified in Article 109k(1) of this Treaty shall retain their powers in the field of monetary policy according to national law.

43.3 In accordance with Article 109k(4) of this Treaty, "Member States" shall be read as "Member States without a derogation" in the following Articles of this Statute: 3, 11.2, 19, 34.2 and 50.

43.4 "National central banks" shall be read as "central banks of Member States without a derogation" in the following Articles of this Statute: 9.2, 10.1, 10.3, 12.1, 16, 17, 18, 22, 23, 27, 30, 31, 32, 33.2 and 52.

43.5 "Shareholders" shall be read as "central banks of Member States without a derogation" in Articles 10.3 and 33.1.

43.6 "Subscribed capital of the ECB" shall be read as "capital of the ECB subscribed by the central banks of Member States without a derogation" in Articles 10.3 and 30.2.

ARTICLE 44 - Transitional tasks of the ECB

The ECB shall take over those tasks of the EMI which, because of the derogations of one or more Member States, still have to be performed in the third stage.

The ECB shall give advice in the preparations for the abrogation of the derogations specified in Article 109l of this Treaty.

ARTICLE 45 - The General Council of the ECB

45.1 Without prejudice to Article 106(3) of this Treaty, the General Council shall be constituted as a third decision-making body of the ECB.

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45.2 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.

45.3 The responsibilities of the General Council are listed in full in Article 47 of this Statute.

ARTICLE 46 - Rules of procedure of the General Council

46.1 The President or, in his absence, the Vice-President of the ECB shall chair the General Council of the ECB.

46.2 The President of the Council and a member of the Commission may participate, without having the right to vote, in meetings of the General Council.

46.3 The President shall prepare the meetings of the General Council.

46.4 By way of derogation from Article 12.3, the General Council shall adopt its Rules of Procedure.

46.5 The Secretariat of the General Council shall be provided by the ECB.

ARTICLE 47 - Responsibilities of the General Council

47.1 The General Council shall:

- perform the tasks referred to in Article 44;
- contribute to the advisory functions referred to in Articles 4 and 25.1.

47.2 The General Council shall contribute to:

- the collection of statistical information as referred to in Article 5;
- the reporting activities of the ECB as referred to in Article 15;
- the establishment of the necessary rules for the application of Article 26 as referred to in Article 26.4;
- the taking of all other measures necessary for the application of Article 29 as referred to in Article 29.4;
- the laying down of the conditions of employment of the staff of the ECB as referred to in Article 36.

47.3 The General Council shall contribute to the necessary preparations for irrevocably fixing the exchange rates of the currencies of Member States with a derogation against the currencies, or the single currency, of the Member States without a derogation, as referred to in Article 109l(5) of this Treaty.

47.4 The General Council shall be informed by the President of the ECB of decisions of the Governing Council.

ARTICLE 48 - Transitional provisions for the capital of the ECB

In accordance with Article 29.1 each national central bank shall be assigned a weighting in the key for subscription of the ECB's capital. By way of derogation from Article 28.3, central banks of Member States with a derogation shall not pay up their subscribed capital unless the General Council, acting by a majority representing at least two thirds

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of the subscribed capital of the ECB and at least half of the shareholders, decides that a minimal percentage has to be paid up as a contribution to the operational costs of the ECB.

ARTICLE 49 - Deferred payment of capital, reserves and provisions of the ECB

49.1 The central bank of a Member State whose derogation has been abrogated shall pay up its subscribed share of the capital of the ECB to the same extent as the central banks of other Member States without a derogation, and shall transfer to the ECB foreign reserve assets in accordance with Article 30.1. The sum to be transferred shall be determined by multiplying the ECU value at current exchange rates of the foreign reserve assets which have already been transferred to the ECB in accordance with Article 30.1, by the ratio between the number of shares subscribed by the national central bank concerned and the number of shares already paid up by the other national central banks.

49.2 In addition to the payment to be made in accordance with Article 49.1, the central bank concerned shall contribute to the reserves of the ECB, to those provisions equivalent to reserves, and to the amount still to be appropriated to the reserves and provisions corresponding to the balance of the profit and loss account as at 31st December of the year prior to the abrogation of the derogation. The sum to be contributed shall be determined by multiplying the amount of the reserves, as defined above and as stated in the approved balance sheet of the ECB, by the ratio between the number of shares subscribed by the central bank concerned and the number of shares already paid up by the other central banks.

ARTICLE 50 - Initial appointment of the members of the Executive Board

When the Executive Board of the ECB is being established, the President, the Vice-President and the other members of the Executive Board shall be appointed by common accord of the governments of the Member States at the level of Heads of State or of Government, on a recommendation from the Council and after consulting the European Parliament and the Council of the EMI. The President of the Executive Board shall be appointed for eight years. By way of derogation from Article 11.2, the Vice-President shall be appointed for four years and the other members of the Executive Board for terms of office of between five and eight years. No term of office shall be renewable. The number of members of the Executive Board may be smaller than provided for in Article 11.1, but in no circumstance shall it be less than four.

ARTICLE 51 - Derogation from Article 32

51.1 If, after the start of the third stage, the Governing Council decides that the application of Article 32 results in significant changes in national central banks' relative income positions, the amount of income to be allocated pursuant to Article 32 shall be reduced by a uniform percentage which shall not exceed 60% in the first financial year after the start of the third stage and which shall decrease by at least 12 percentage points in each subsequent financial year.

51.2 Article 51.1 shall be applicable for not more than five financial years after the start of the third stage.

Annex III**ARTICLE 52 - Exchange of bank notes in Community currencies**

Following the irrevocable fixing of exchange rates, the Governing Council shall take the necessary measures to ensure that bank notes denominated in currencies with irrevocably fixed exchange rates are exchanged by the national central banks at their respective par values.

ARTICLE 53 - Applicability of the transitional provisions

If and as long as there are Member States with a derogation Articles 43 to 48 shall be applicable.

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TREATY ON EUROPEAN UNION
AS SIGNED ON 7TH FEBRUARY 1992

PROTOCOL
ON THE STATUTE OF THE EUROPEAN MONETARY INSTITUTE

THE HIGH CONTRACTING PARTIES,

DESIRING to lay down the Statute of the European Monetary Institute,

HAVE AGREED upon the following provisions, which shall be annexed to the Treaty establishing the European Community:

ARTICLE 1 - Constitution and name

1.1 The European Monetary Institute (EMI) shall be established in accordance with Article 109f of this Treaty; it shall perform its functions and carry out its activities in accordance with the provisions of this Treaty and of this Statute.

1.2 The members of the EMI shall be the central banks of the Member States ("national central banks"). For the purposes of this Statute, the Institut monétaire luxembourgeois shall be regarded as the central bank of Luxembourg.

1.3 Pursuant to Article 109f of this Treaty, both the Committee of Governors and the European Monetary Co-operation Fund (EMCF) shall be dissolved. All assets and liabilities of the EMCF shall pass automatically to the EMI.

ARTICLE 2 - Objectives

The EMI shall contribute to the realisation of the conditions necessary for the transition to the third stage of Economic and Monetary Union, in particular by:

- strengthening the co-ordination of monetary policies with a view to ensuring price stability;
- making the preparations required for the establishment of the European System of Central Banks (ESCB), and for the conduct of a single monetary policy and the creation of a single currency in the third stage;
- overseeing the development of the ECU.

ARTICLE 3 - General principles

3.1 The EMI shall carry out the tasks and functions conferred upon it by this Treaty and this Statute without prejudice to the responsibility of the competent authorities for the conduct of the monetary policy within the respective Member States.

3.2 The EMI shall act in accordance with the objectives and principles stated in Article 2 of the Statute of the ESCB.

ARTICLE 4 - Primary tasks

4.1 In accordance with Article 109f(2) of this Treaty, the EMI shall:

- strengthen co-operation between the national central banks;

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- strengthen the co-ordination of the monetary policies of the Member States with the aim of ensuring price stability;
 - monitor the functioning of the European Monetary System (EMS);
 - hold consultations concerning issues falling within the competence of the national central banks and affecting the stability of financial institutions and markets;
 - take over the tasks of the EMCF; in particular it shall perform the functions referred to in Articles 6.1, 6.2 and 6.3;
 - facilitate the use of the ECU and oversee its development, including the smooth functioning of the ECU clearing system.
- The EMI shall also:
- hold regular consultations concerning the course of monetary policies and the use of monetary policy instruments;
 - normally be consulted by the national monetary authorities before they take decisions on the course of monetary policy in the context of the common framework for ex ante co-ordination.

4.2 At the latest by 31st December 1996, the EMI shall specify the regulatory, organisational and logistical framework necessary for the ESCB to perform its tasks in the third stage, in accordance with the principle of an open market economy with free competition. This framework shall be submitted by the Council of the EMI for decision to the ECB at the date of its establishment.

In accordance with Article 109f(3) of this Treaty, the EMI shall in particular:

- prepare the instruments and the procedures necessary for carrying out a single monetary policy in the third stage;
- promote the harmonisation, where necessary, of the rules and practices governing the collection, compilation and distribution of statistics in the areas within its field of competence;
- prepare the rules for operations to be undertaken by the national central banks in the framework of the ESCB;
- promote the efficiency of cross-border payments;
- supervise the technical preparation of ECU bank notes.

ARTICLE 5 - Advisory functions

5.1 In accordance with Article 109f(4) of this Treaty, the Council of the EMI may formulate opinions or recommendations on the overall orientation of monetary policy and exchange rate policy as well as on related measures introduced in each Member State. The EMI may submit opinions or recommendations to governments and to the Council on policies which might affect the internal or external monetary situation in the Community and, in particular, the functioning of the EMS.

5.2 The Council of the EMI may also make recommendations to the monetary authorities of the Member States concerning the conduct of their monetary policy.

5.3 In accordance with Article 109f(6) of this Treaty, the EMI shall be consulted by the Council regarding any proposed Community act within its field of competence.

Within the limits and under the conditions set out by the Council acting by a qualified majority on a proposal from the Commission and after consulting the European Parliament and the EMI, the EMI shall be consulted by the authorities of the Member States on any draft legislative

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provision within its field of competence, in particular with regard to Article 4.2.

5.4 In accordance with Article 109f(5) of this Treaty, the EMI may publish its opinions and its recommendations.

ARTICLE 6 - Operational and technical functions

6.1 The EMI shall:

- provide for the multilateralisation of positions resulting from interventions by the national central banks in Community currencies and the multilateralisation of intra-Community settlements;
- administer the very short-term financing mechanism provided for by the Agreement of 13th March 1979 between the central banks of the Member States of the European Economic Community laying down the operating procedures for the European Monetary System (hereinafter referred to as "EMS Agreement") and the short-term monetary support mechanism provided for in the Agreement between the central banks of the Member States of the European Economic Community of 9th February 1970, as amended;
- perform the functions referred to in Article 11 of Council Regulation (EEC) No. 1969/88 of 24th June 1988 establishing a single facility providing medium-term financial assistance for Member States' balances of payments.

6.2 The EMI may receive monetary reserves from the national central banks and issue ECUs against such assets for the purpose of implementing the EMS Agreement. These ECUs may be used by the EMI and the national central banks as a means of settlement and for transactions between them and the EMI. The EMI shall take the necessary administrative measures for the implementation of this paragraph.

6.3 The EMI may grant to the monetary authorities of third countries and to international monetary institutions the status of "Other Holders" of ECUs and fix the terms and conditions under which such ECUs may be acquired, held or used by Other Holders.

6.4 The EMI shall be entitled to hold and manage foreign exchange reserves as an agent for and at the request of national central banks. Profits and losses regarding these reserves shall be for the account of the national central bank depositing the reserves.

The EMI shall perform this function on the basis of bilateral contracts in accordance with rules laid down in a decision of the EMI.

These rules shall ensure that transactions with these reserves shall not interfere with the monetary policy and exchange rate policy of the competent monetary authority of any Member State and shall be consistent with the objectives of the EMI and the proper functioning of the Exchange Rate Mechanism of the EMS.

ARTICLE 7 - Other tasks

7.1 Once a year the EMI shall address a report to the Council on the state of the preparations for the third stage. These reports shall include an assessment of the progress towards convergence in the Community, and cover in particular the adaptation of monetary policy instruments and the preparation of the procedures necessary for carrying out a single monetary policy in the third stage, as well as the statutory requirements

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to be fulfilled for national central banks to become an integral part of the ESCB.

7.2 In accordance with the Council decisions referred to in Article 109f(7) of this Treaty, the EMI may perform other tasks for the preparation of the third stage.

ARTICLE 8 - Independence

The members of the Council of the EMI who are the representatives of their institutions shall, with respect to their activities, act according to their own responsibilities. In exercising the powers and performing the tasks and duties conferred upon them by this Treaty and this Statute, the Council of the EMI may not seek or take any instructions from Community institutions or bodies or governments of Member States.

The Community institutions and bodies as well as the governments of the Member States undertake to respect this principle and not to seek to influence the Council of the EMI in the performance of its tasks.

ARTICLE 9 - Administration

9.1 In accordance with Article 109f(1) of this Treaty, the EMI shall be directed and managed by the Council of the EMI.

9.2 The Council of the EMI shall consist of a President and the Governors of the national central banks, one of whom shall be Vice-President. If a Governor is prevented from attending a meeting, he may nominate another representative of his institution.

9.3 The President shall be appointed by common accord of the governments of the Member States at the level of Heads of State or of Government, on a recommendation from, as the case may be, the Committee of Governors or the Council of the EMI, and after consulting the European Parliament and the Council.

The President shall be selected from among persons of recognised standing and professional experience in monetary or banking matters. Only nationals of Member States may be President of the EMI. The Council of the EMI shall appoint the Vice-President. The President and Vice-President shall be appointed for a period of three years.

9.4 The President shall perform his duties on a full-time basis. He shall not engage in any occupation, whether gainful or not, unless exemption is exceptionally granted by the Council of the EMI.

9.5 The President shall:

- prepare and chair the meetings of the Council of the EMI;
- without prejudice to Article 22, present the views of the EMI externally;
- be responsible for the day-to-day management of the EMI.

In the absence of the President, his duties shall be performed by the Vice-President.

9.6 The terms and conditions of employment of the President, in particular his salary, pension and other social security benefits, shall be the subject of a contract with the EMI and shall be fixed by the Council of the EMI on a proposal from a Committee comprising three members appointed by the Committee of Governors or the Council of the EMI, as the case may

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be, and three members appointed by the Council. The President shall not have the right to vote on matters referred to in this paragraph.

9.7 If the President no longer fulfils the conditions required for the performance of his duties or if he has been guilty of serious misconduct, the Court of Justice may, on application by the Council of the EMI, compulsorily retire him.

9.8 The Rules of Procedure of the EMI shall be adopted by the Council of the EMI.

ARTICLE 10 - Meetings of the Council of the EMI and voting procedures

10.1 The Council of the EMI shall meet at least ten times a year. The proceedings of Council meetings shall be confidential. The Council of the EMI may, acting unanimously, decide to make the outcome of its deliberations public.

10.2 Each member of the Council of the EMI or his nominee shall have one vote.

10.3 Save as otherwise provided for in this Statute, the Council of the EMI shall act by a simple majority of its members.

10.4 Decisions to be taken in the context of Articles 4.2, 5.4, 6.2 and 6.3 shall require unanimity of the members of the Council of the EMI.

The adoption of opinions and recommendations under Articles 5.1 and 5.2, the adoption of decisions under Articles 6.4, 16 and 23.6 and the adoption of guidelines under Article 15.3 shall require a qualified majority of two-thirds of the members of the Council of the EMI.

ARTICLE 11 - Inter-institutional co-operation and reporting requirements

11.1 The President of the Council and a member of the Commission may participate, without having the right to vote, in meetings of the Council of the EMI.

11.2 The President of the EMI shall be invited to participate in Council meetings when the Council is discussing matters relating to the objectives and tasks of the EMI.

11.3 At a date to be established in the Rules of Procedure, the EMI shall prepare an annual report on its activities and on monetary and financial conditions in the Community. The annual report, together with the annual accounts of the EMI, shall be addressed to the European Parliament, the Council and the Commission and also to the European Council.

The President of the EMI may, at the request of the European Parliament or on his own initiative, be heard by the competent Committees of the European Parliament.

11.4 Reports published by the EMI shall be made available to interested parties free of charge.

ARTICLE 12 - Currency denomination

The operations of the EMI shall be expressed in ECU.

ARTICLE 13 - Seat

Before the end of 1992, the decision as to where the seat of the EMI will be established shall be taken by common accord of the

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governments of the Member States at the level of Heads of State or of Government.

ARTICLE 14 - Legal capacity

The EMI, which in accordance with Article 109f(1) of this Treaty shall have legal personality, shall enjoy in each of the Member States the most extensive legal capacity accorded to legal persons under their law; it may, in particular, acquire or dispose of movable or immovable property and may be a party to legal proceedings.

ARTICLE 15 - Legal acts

15.1 In the performance of its tasks, and under the conditions laid down in this Statute, the EMI shall:

- deliver opinions;
- make recommendations;
- adopt guidelines, and take decisions, which shall be addressed to the national central banks.

15.2 Opinions and recommendations of the EMI shall have no binding force.

15.3 The Council of the EMI may adopt guidelines laying down the methods for the implementation of the conditions necessary for the ESCB to perform its functions in the third stage. EMI guidelines shall have no binding force; they shall be submitted for decision to the ECB.

15.4 Without prejudice to Article 3.1, a decision of the EMI shall be binding in its entirety upon those to whom it is addressed. Articles 190 and 191 of this Treaty shall apply to these decisions.

ARTICLE 16 - Financial resources

16.1 The EMI shall be endowed with its own resources. The size of the resources of the EMI shall be determined by the Council of the EMI with a view to ensuring the income deemed necessary to cover the administrative expenditure incurred in the performance of the tasks and functions of the EMI.

16.2 The resources of the EMI determined in accordance with Article 16.1 shall be provided out of contributions by the national central banks in accordance with the key referred to in Article 29.1 of the Statute of the ESCB and be paid up at the establishment of the EMI. For this purpose, the statistical data to be used for the determination of the key shall be provided by the Commission, in accordance with the rules adopted by the Council, acting by a qualified majority on a proposal from the Commission and after consulting the European Parliament, the Committee of Governors and the Committee referred to in Article 109c of this Treaty.

16.3 The Council of the EMI shall determine the form in which contributions shall be paid up.

ARTICLE 17 - Annual accounts and auditing

17.1 The financial year of the EMI shall begin on the first day of January and end on the last day of December.

17.2 The Council of the EMI shall adopt an annual budget before the beginning of each financial year.

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17.3 The annual accounts shall be drawn up in accordance with the principles established by the Council of the EMI. The annual accounts shall be approved by the Council of the EMI and shall thereafter be published.

17.4 The annual accounts shall be audited by independent external auditors approved by the Council of the EMI. The auditors shall have full power to examine all books and accounts of the EMI and to obtain full information about its transactions.

The provisions of Article 188b of this Treaty shall only apply to an examination of the operational efficiency of the management of the EMI.

17.5 Any surplus of the EMI shall be transferred in the following order:

- (a) an amount to be determined by the Council of the EMI shall be transferred to the general reserve fund of the EMI;
- (b) any remaining surplus shall be distributed to the national central banks in accordance with the key referred to in Article 16.2.

17.6 In the event of a loss incurred by the EMI, the shortfall shall be offset against the general reserve fund of the EMI. Any remaining shortfall shall be made good by contributions from the national central banks, in accordance with the key as referred to in Article 16.2.

ARTICLE 18 - Staff

18.1 The Council of the EMI shall lay down the conditions of employment of the staff of the EMI.

18.2 The Court of Justice shall have jurisdiction in any dispute between the EMI and its servants within the limits and under the conditions laid down in the conditions of employment.

ARTICLE 19 - Judicial control and related matters

19.1 The acts or omissions of the EMI shall be open to review or interpretation by the Court of Justice in the cases and under the conditions laid down in this Treaty. The EMI may institute proceedings in the cases and under the conditions laid down in this Treaty.

19.2 Disputes between the EMI, on the one hand, and its creditors, debtors or any other person, on the other, shall fall within the jurisdiction of the competent national courts, save where jurisdiction has been conferred upon the Court of Justice.

19.3 The EMI shall be subject to the liability regime provided for in Article 215 of this Treaty.

19.4 The Court of Justice shall have jurisdiction to give judgement pursuant to any arbitration clause contained in a contract concluded by or on behalf of the EMI, whether that contract be governed by public or private law.

19.5 A decision of the EMI to bring an action before the Court of Justice shall be taken by the Council of the EMI.

Annex IV**ARTICLE 20 - Professional secrecy**

20.1 Members of the Council of the EMI and the staff of the EMI shall be required, even after their duties have ceased, not to disclose information of the kind covered by the obligation of professional secrecy.

20.2 Persons having access to data covered by Community legislation imposing an obligation of secrecy shall be subject to such legislation.

ARTICLE 21 - Privileges and immunities

The EMI shall enjoy in the territories of the Member States such privileges and immunities as are necessary for the performance of its tasks, under the conditions laid down in the Protocol on the Privileges and Immunities of the European Communities annexed to the Treaty establishing a Single Council and a Single Commission of the European Communities.

ARTICLE 22 - Signatories

The EMI shall be legally committed to third parties by the President or the Vice-President or by the signatures of two members of the staff of the EMI who have been duly authorised by the President to sign on behalf of the EMI.

ARTICLE 23 - Liquidation of the EMI

23.1 In accordance with Article 1091 of this Treaty, the EMI shall go into liquidation on the establishment of the ECB.

All assets and liabilities of the EMI shall then pass automatically to the ECB.

The latter shall liquidate the EMI according to the provisions of this Article.

The liquidation shall be completed by the beginning of the third stage.

23.2 The mechanism for the creation of ECUs against gold and US dollars as provided for by Article 17 of the EMS Agreement shall be unwound by the first day of the third stage in accordance with Article 20 of the said Agreement.

23.3 All claims and liabilities arising from the very short-term financing mechanism and the short-term monetary support mechanism, under the Agreements referred to in Article 6.1, shall be settled by the first day of the third stage.

23.4 All remaining assets of the EMI shall be disposed of and all remaining liabilities of the EMI shall be settled.

23.5 The proceeds of the liquidation described in Article 23.4 shall be distributed to the national central banks in accordance with the key referred to in Article 16.2.

23.6 The Council of the EMI may take the measures necessary for the application of Articles 23.4 and 23.5.

23.7 Upon the establishment of the ECB, the President of the EMI shall relinquish his office.