Committee of Governors of the
Central Banks of the Member States
of the European Economic Community

27th November 1990

INTRODUCTORY REPORT ON THE DRAFT STATUTE OF THE EUROPEAN SYSTEM OF CENTRAL BANKS AND OF THE EUROPEAN CENTRAL BANK

Introduction

In Madrid in June 1989 the European Council asked the competent bodies of the Community to carry out the preparatory work for the organisation of an Intergovernmental Conference to lay down the subsequent stages of Economic and Monetary Union.

In this context, the Committee of Governors, whose meetings are regularly attended by a member of the Commission, has had extensive discussions on the monetary aspects of the final stage of Economic and Monetary Union. The point of departure of the Committee's deliberations was the concepts developed in the "Report on Economic and Monetary Union in the European Community" (the "Delors Report"), but the preparatory work undertaken by other Community bodies has also been taken into account.

The Chairman of the Committee of Governors has reported on several occasions to the ECOFIN on the progress made by the Committee in its work, the outcome of which is the attached draft Statute of the "European System of Central Banks and of the European Central Bank", hereinafter called the "System".

Principal considerations underlying the Statute

In preparing the Statute the Committee of Governors has assumed that there is a clear political will and a firm commitment to continue with the process of economic and monetary integration to the final stage of Economic and Monetary Union. Indeed, the Statute, as presented, focuses entirely on that objective, i.e. when a situation has been reached where a decision has been taken to lock irreversibly exchange rates between participating Community currencies and where subsequently a single currency will be issued which will replace the present national currencies. The Statute allows for the changes involved in the move from national currencies with permanently fixed exchange rates to a single Community currency as well as those arising from the continuing process of financial market integration.

While the Statute encompasses a detailed and comprehensive set of institutional and organisational provisions, it still needs to be completed in two respects. Firstly, the Statute does not yet deal with the complex issues of transitional arrangements, i.e. the decisions on the necessary preparatory steps to be implemented in Stage Two, the transition to Stage Three, the start-up procedures and the implications of full participation in the System by some of the Member States at different dates. Secondly, certain aspects of a more technical nature, especially those relating to the distribution of income, and some legal questions are still under consideration.

The Committee of Governors has the intention to complete the Statute in these areas and to present its proposals in the course of the Intergovernmental Conference. At the same time it is understood that, in accordance with Article 102a of the EEC Treaty, the Committee of Governors will be consulted regarding any proposals made during the Intergovernmental Conference for institutional changes in the monetary area. It may also on its own initiative wish to give further consideration to certain provisions of the draft Statute.

The Committee of Governors could not reach full agreement on a few provisions which have therefore been put between square brackets in the Statute. These issues concern the responsibility for exchange rate policy, the procedure for giving operational powers to the Executive Board, the embodiment of the principle of subsidiarity in the Statute and the need for collateral in lending to credit institutions.

Moreover, the Governor of the Bank of England records that the UK authorities do not accept the case for a single currency and monetary policy. He has nevertheless participated fully in the discussions of the Governors' Committee on this Statute. He recognises that it is the desire of the other Governors to define the responsibilities and functions of a possible future European System of Central Banks, before the Intergovernmental Conferences are convened in December 1990.

The main organisational features of the System

As stated in Article 1, the System consists of a new central institution - The European Central Bank (ECB), endowed with legal personality - and the central banks of the Member States. For the System to operate efficiently and coherently Article 14 obliges the Member States to ensure that national legislation, including the statutes of the national central banks, are compatible with the Statute and the EEC Treaty. The System as such has no legal personality and should be regarded only as a term describing the existence of the ECB and the national central banks as integral parts of the System, governed by a common set of rules and committed to the objectives and tasks entrusted to it. The System is governed by the decision-making bodies of the ECB, which will be the Council and the Executive Board.

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 bodies. On the other hand, it offers the possibility of executing operations arising from the System's tasks through both the ECB and the national central banks. Although there is a consensus that, in accordance with the principle of subsidiarity, there is a presumption for carrying out such operations through the national central banks, views differ as to how the principle of subsidiarity should be embodied in the Statute. Most Community central banks agree on the formulation that to the full extent possible in the judgment of the Council the national central banks shall execute operations arising out of the System's tasks. Some Community central banks prefer the formulation that the Executive Board shall make use of the national central banks, to the extent possible and appropriate, in the execution of such operations.

The Basic Principles

(a) The Primary Objective

As stated in Article 2 the primary objective of the System shall be to maintain price stability. However, as also indicated in that Article, this does not mean that monetary policy will be carried out in isolation and without due regard to other economic policy objectives. There is clear recognition that the System shall, without prejudice to the primary objective, support the general economic policy of the Community.

In addition, Article 3 lists those tasks which are normally associated with the activity of a central bank and Article 4 specifies several advisory functions.

(b) Indivisibility and centralisation of monetary policy

The single most important characteristic of monetary policy is that it is indivisible and that the responsibility for monetary policy cannot be shared out between autonomously acting bodies. The Statute ensures that with the move to the final stage, responsibility for the formulation and implementation of the monetary policy of the Community will be vested with the System and be formally attributed to the Council and the Executive Board of the ECB.

In accordance with Article 12, the Council will be the supreme decision-making body on all matters relating to the System's tasks and operations. This involves in particular the strategic monetary policy decisions including those on intermediate monetary objectives, key interest rates and the supply of reserves in the System and the establishment of guidelines for their implementation. At the same time, as the daily execution of monetary policies takes place in an environment of rapidly changing market conditions, there is a continuous need for operational decisions. There is full agreement that the daily management of monetary policy should be in the hands of the Executive Board, which would act in accordance with the decisions and guidelines established by the Council. However, views differ as to how the necessary authority should be conferred upon the Executive Board. All but one member of the Committee of Governors favour an approach under which the Council would be obliged to delegate the necessary operational powers to the Executive Board. This is considered to underscore the position of the Council as the supreme decision-making body. One Committee member is of the view that an efficient monetary management makes it necessary to give explicitly to the Executive Board the responsibility for implementing the monetary policy.

(c) Federalism and subsidiarity

While the Statute provides for centralised decision-making in conformity with the indivisibility of monetary policy, it fully respects the federative structure of the Community. In accordance with Article 10, the Governors of all national central banks will be ex officio members of the Council. Except for some specific "patrimonial" decisions (see below:

"(g) The financial arrangements"), each Council member will have one vote. In particular in the area of monetary policy decision-making voting on the basis of "one person, one vote" is conditioned by the need to direct such decisions to the requirements of the Community as a whole rather than to regional considerations. This voting procedure thus serves to strengthen the System's decision-making process.

The federative structure of the System is also reflected in the execution of operations arising out of the System's tasks, which, as mentioned above, rests firmly on the application of the principle of subsidiarity (Article 14). The reliance on national central banks as operational arms of the System is also one of the important reasons why their statutes will have to be made compatible - but not necessarily uniform across countries - with the provisions of the Statute and the EEC Treaty. At the same time, national central banks may have responsibilities of their own, for example, in settling payments, performing tasks in the important area of banking supervision or carrying out business on behalf of government institutions. Moreover, Article 14 authorises national central banks to perform functions outside those prescribed in the Statute, unless they interfere with the objectives and tasks of the System.

(d) The independence of the System

In order to enable the System to attain the primary objective of price stability it is important that the decision-making bodies should not be influenced by considerations which would be in conflict with the pursuit of price stability. Article 7 states that the ECB, the national central banks and their decision-making bodies shall act independently of instructions from political authorities. The favourable experience with independent monetary authorities made by 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.

One important aspect of independence is that the members of the Council and the Executive Board should be able to exercise their powers and perform their tasks in a situation of assured tenure. Accordingly, Articles 11 and 14 specifically refer to the term of office and stipulate the conditions and procedures under which the members of the decision-making bodies can be relieved from office.

While Article 7 firmly embodies the principle of independence in the Statute, other provisions give it practical effect by determining the functional, operational and financial conditions which need to be met so that the System can act with the necessary degree of autonomy.

(e) Democratic accountability of the System

While independence is considered to be an essential prerequisite for the fulfilment of the System's objectives and tasks, it is also fully recognised in the Statute that there must be democratic legitimacy and accountability. This is to a significant extent ensured by the fact that the Treaty (and the Statute annexed to it) will have to be approved by Member States and be ratified by their parliaments. The powers entrusted to the decision-making bodies and the scope of their responsibilities are clearly defined in the Statute and the members of the decision-making bodies will be appointed by the appropriate political authorities. The President and the Vice-President of the Executive Board (who also preside over the Council) will be nominated by the European Council after consultation with the European Parliament.

Transparency is an important element of democratic accountability. To this end, the Statute calls for the preparation of an annual report which the President of the Council shall present to the European Council, the Council of the European Communities and the Parliament. The transparency of the System is further enhanced in Article 15 by enabling the President of the Council of the European Communities and a member of the Commission to attend meetings of the Council of the ECB. In addition, the ECB will report regularly on the activities of the System and will publish consolidated financial statements of the System.

(f) The fundamental functional and operational features of the System

In order to ensure that the Council and the Executive Board can direct monetary policy towards price stability, they should not be obliged to fulfil tasks which would render it extremely difficult, if not impossible, to attain the primary objective of the System. For this reason, Article 21 denies the ECB and the national central banks the possibility of giving overdrafts or any other type of credit facility to public entities. Publicly-owned credit institutions should of course have access to credit from the System in the conduct of their normal banking operations. In the context of the external operations Article 3 entrusts the System with the task of conducting foreign exchange operations in accordance with the prevailing exchange rate regime of the Community. While Article 4.3 acknowledges that the responsibility for decisions concerning the Community's exchange rate regime rests with the political authorities, it also needs to be taken into account that operations in the exchange market are closely interconnected with monetary policy and, thus, may have a direct bearing on the System's ability to attain its primary objective. For this reason Article 4.3 establishes the obligation to consult the ECB with a view to reaching consensus consistent with the objective of price stability prior to any decision relating to the exchange rate regime. However, views differ with regard to the ECB's role in the decisions about exchange rate policy. Most of the members of the Committee of Governors are of the view that decisions on the Community's exchange rate policy should be taken in the same way as decisions on the adoption, abandonment or change in central rates vis-à-vis third currencies. Some Committee members are of the view that decisions on the Community's exchange rate policy should be subject to the consent of the ECB.

In order to be able to act autonomously, it is also essential that the ECB and the national central banks are given the necessary policy instruments (see Articles 18 to 20) and that those instruments can be used without restrictions. The relevant provisions have been drafted with due regard to the evolutionary nature of financial markets and will allow the System to respond adequately to changing market conditions.

In order to be able to perform its tasks the System is given three important complementary functions. Firstly, in its advisory capacity the ECB is to be consulted regarding any draft Community legislation (as well as any national legislation within the ECB's field of competence) and any envisaged international agreements in the monetary, prudential, banking or financial field (Article 4.1). Secondly, the ECB, assisted by the national central banks, will be entitled to collect the statistical information necessary for the performance of the System's tasks and, where necessary, the ECB shall promote the harmonisation of the conditions governing the collection, compilation and distribution of statistics in the areas within its field of competence. Thirdly, the System will participate as necessary in the formulation, co-ordination and execution of policies relating to prudential supervision and the stability of the financial system.

(g) The financial arrangements

The provisions of Chapter VI establish the financial foundations of the System which ensure its financial autonomy. In particular, the provisions govern the endowment of the ECB with capital and foreign assets (Articles 29 and 30). Provisions relating to rules for the distribution of income deriving from the System's operations are still under consideration.

Two principal features characterise these financial arrangements. Firstly, in accordance with the tasks entrusted to the System, and the ensuing operational requirements, provision has been made for endowing the ECB with capital and for pooling in its books foreign reserve assets as necessary to ensure the credibility of the System. Secondly, the subscription of capital to the ECB and the transfer of foreign reserve assets to the ECB are based on a single key which is to be established with due regard to objective indicators, such as GNP, and possibly population and financial criteria. The key also defines the numbers of votes each national central bank Governor will have in decisions on financial matters, which, in accordance with Articles 10.3 and 28, are the only areas in which weighted voting will apply.

The Statute does not yet prescribe precise amounts for the capital of the ECB or the total of pooled foreign reserve assets. There is, however, agreement in the Committee of Governors that the volume of foreign assets to be placed at the disposal of the ECB should be sufficiently high to make the foreign exchange policy credible in the eyes of market participants. Accordingly Article 30 prescribes that the Council will be entitled to call up - in successive steps - up to a predetermined limit foreign reserve assets from the national central banks. Further calls of such assets, beyond the fixed limit, may be made only in accordance with a procedure determined by Community legislation.

Depending on the extent of pooling at the outset, this approach could imply that a part of foreign reserve assets remains in the hands of national authorities. In order to ensure that these residual reserve assets are held and used in a manner which is consistent with the Community's exchange rate and monetary policies, Article 31 states that all operations (except those in fulfilment of obligations to international organisations) involving foreign reserve assets can be carried out by the national central banks only with approval of the ECB. However, for all foreign reserve assets in the Community to be effectively under the control of the ECB, all but one member of the Committee of Governors agree that it will be necessary to bring such assets into the System at the start of Stage Three. To this effect the Treaty should stipulate that all foreign reserve assets held by non-central bank entities are to be transferred to the national central banks of the countries concerned.

Legal Aspects

(a) Enshrinement in the Treaty

It is proposed to annex the Statute to the new Treaty in the form of a Protocol. This ensures that the Statute - as the Treaty itself - will have the status of primary Community law and therefore any amendment of the Statute would normally be subjected to the procedure applied to EEC Treaty changes. At the same time, as the Statute forms a self-contained piece of legislation it will not only include the fundamental constitutional provisions but also those of a more technical nature. In order to preserve some flexibility for amending such technical provisions in response to changing circumstances it is necessary to introduce in the Statute a simplified amendment procedure. However, since the legislative procedures of the Community are expected to be revised in the context of the Intergovernmental Conference on Political Union, the Committee of Governors considers it premature to make a concrete proposal for a simplified amendment procedure. The completion of Chapter IX, which will contain the necessary provisions, should therefore await the outcome of the Intergovernmental Conference. The Committee of Governors is firmly of the view that all fundamental features of the System should definitely be excluded from simplified amendment procedures. The Treaty itself should include provisions which refer inter alia to the establishment of the System comprising the ECB and the national central banks, its objectives, its tasks, its powers as well as its independence.

(b) Legal structure

The System as a whole does not enjoy legal personality but its constituent parts have separate legal personality, established explicitly for the ECB in Article 9 and - implicitly - retained by the national central banks in accordance with national law. This implies that only the ECB and the national central banks, but not the System, can own, buy and sell assets, conclude contracts and be a party in legal proceedings.

Under this construction the decision-making bodies benefit from the ECB's legal personality, i.e. the ECB will be liable for the acts and decisions taken by the Council and the Executive Board, and there is thus no legal uncertainty as to whether the Community would have to assume liability for the System.

(c) <u>The nature of the System in the framework of Community institutions</u>

It is proposed that the European System of Central Banks is not classified as a Community institution in accordance with Article 4, Paragraph 1 of the EEC Treaty. Instead, it is suggested that the establishment of the System is mentioned separately in a new paragraph of that Article. In order to avoid any legal uncertainty arising from the possible application to the System of general provisions relating to Community institutions, the Statute contains a special Chapter (VII) which includes the necessary provisions governing the general aspects of the System. In many instances these provisions are broadly similar to those contained in the existing EEC Treaty.

<u>Concluding comments</u>

The attached draft Statute has been designed with two considerations in mind. On the one hand, the System must be built on those fundamental institutional requirements which are essential for the performance of its task and the attainment of its objectives; on the other hand, it must allow for changes arising from further economic and financial integration of the Community, the time and speed at which these changes will occur being difficult to predict. Indeed, the state of market integration will have important operational implications for the System. Moreover, changes implied by the move to a single currency in the final stage will also have to be allowed for under the Statute. For these reasons the Committee of Governors has chosen to follow a pragmatic approach by leaving many of the operational features to the decision of the Council rather than defining now in great detail operational aspects which may be outdated by the time the System is established.

By contrast, the institutional principles on which the System needs to be founded in order to provide greatest possible assurance for the attainment of its objectives, have been fully embodied in the Statute. The

Committee of Governors is firmly of the view that indivisibility of monetary policy, independence and democratic accountability, federalism and subsidiarity, denial of monetary financing to the public sector, freedom to conduct foreign exchange market operations in the framework of the Community's exchange rate regime, availability of the appropriate policy instruments and financial autonomy are indispensable cornerstones of a System committed to the maintenance of price stability.

Finally, the Committee of Governors wishes to emphasise that the success of the System in performing its functions and tasks does not solely depend on its operational and institutional features. As has been pointed out in the Delors Report "economic union and monetary union form two integral parts of a single whole" and have to be implemented in parallel. Indeed, only if adequate progress has been made in the economic field, in particular with regard to ensuring budgetary discipline, will the System be able to operate in an environment in which it can successfully attain its primary objective of price stability.