



EUROPEAN CENTRAL BANK

Jean-Claude TRICHET
President

L/JCT/05/660

Mr Nikolaos Vakalis
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13 June 2005

Dear Mr Vakalis,

Thank you for your letter dated 28 April 2005 regarding the decision of the Governing Council of the ECB of 18 November 2004 not to introduce very low denomination euro banknotes. I would like to reply to your questions as follows:

- *"Could we have some detailed information on the above, i.e. the information on which the above-mentioned decision of the Governing Council was based, indicating that there is no demand among European citizens for low-denomination banknotes?"*

The question *"Would you personally like a €1 banknote to be issued?"* was included in the public surveys conducted by the European Commission in the years 2002 and 2003 in the euro area (Eurobarometer surveys). These surveys showed that only some 20 to 30% of cash users would like a €1 banknote to be issued.

- *"Exactly what practical problems are expected to arise? Have any consultations taken place with the organisations concerned (companies, banks, etc.)?"*

Prior to the above-mentioned decision of the Governing Council, the ECB sought the views of businesses via the relevant European associations of the banking, security transport, retail and vending machine sectors. All of these strongly opposed the introduction of very low value banknotes, mainly for the following reasons:

- Parallel circulation of banknotes and coins of the same value would increase costs for businesses since it would require them to invest in adaptations (e.g. new cash drawers) even though, ultimately, one of the two means of payment might hardly circulate.
 - New €1 or €2 banknotes could not be dispensed via automated teller machines (ATMs) as that would require too frequent – and thus costly – re-filling. Instead, retail businesses would be the main distribution channel to the public for such very low denomination banknotes, using them as change. As it would be very difficult to ensure a regular supply of new very low denomination banknotes, used banknotes would stay in circulation longer, leading to a deterioration of the quality of the banknotes in circulation. Poor quality banknotes complicate the authentication and overall handling of banknotes, e.g. in automated banknote processing by different parties.
 - Very low denomination banknotes would increase the costs for handling cash in banks, cash-in-transit companies and the retail and vending sectors. One-off adaptations, especially of cash-accepting machines, would be significant, considering that banknote validators are three times more expensive than coin validators.
- *“What exactly will be the cost of issuing such banknotes?”*

While coins, as a rule, last several decades, it is assumed that the life span of a €1 or €2 banknote would be around one year, thus generating high replacement costs. Costs for processing used banknotes of very low denomination would be significant in view of their poor quality due to more rapid wear and tear. The overall costs for the Eurosystem of printing, processing and destroying €1 or €2 banknotes would be about €100 million per year.

- *“Specifically, what is the ECB’s view of the fact that despite quite a long period of adaptation to the changeover to the euro, many Europeans still encounter problems, not only in getting used to the new currency, but also more generally in terms of ‘behaviour’ (e.g. Greeks and Italians feel uncomfortable leaving coins as tips), leading to reckless spending?”*

It should be recalled that, both before and after the euro cash changeover, comprehensive and intense information efforts were made both at the European and national levels to inform the general public about the visual appearance and security features of the euro banknotes and coins and to help the European citizens to get acquainted with the single currency. The Eurosystem continues to provide information on the euro on an ongoing basis, both to the general public and specific target groups (such as retailers and other important cash handlers).

- *“The circulation of €1 and €2 banknotes will undoubtedly help to curb high prices and inflation in some countries: does this not constitute an advantage which outweighs any disadvantages of the cost of issuing such banknotes? And, if not, how did the ECB (from a macroeconomic point of view) arrive at this conclusion?”*

Prior to its decision not to issue €1 or €2 banknotes, the ECB conducted comprehensive studies and consultations which indicated that the potential advantages of issuing very low denomination banknotes were difficult to quantify. Most importantly, no evidence could be found for the argument that the lack of very low denomination banknotes would fuel inflation. While it is difficult to estimate the macroeconomic effects of using coins rather than very low denomination banknotes, no proof could be found that the lack of very low denomination banknotes led to price increases after the euro cash changeover.

- *“Have any consultations taken place with organisations representing the interests of consumers? If so, what are the findings of those consultations, and how were they assessed in relation to consultations with other organisations (e.g. banks)?”*

Neither of the European consumer organisations consulted – the Bureau Européen des Unions de Consommateurs (BEUC) and the European Community of Consumer Co-operatives (EURO COOP) – supported the parallel circulation of €1 and/or €2 banknotes and coins as such parallel circulation would carry the risk of confusing consumers. As regards the consultation of business sectors, please refer to the information provided above.

- *“Has there been an assessment – and, if so, what assessment was made – of the situation following enlargement, taking account of the future introduction of the euro in the accession countries? In the context of a ‘prudent’ policy, should the decision on issuing €1 and €2 banknotes not take account of the prospects for entry of the new Member States into the euro area?”*

With respect to the argument that the introduction of €1 or €2 banknotes would be likely to facilitate the acceptance of euro cash in those EU Member States with a derogation in which banknotes with very low denominations are in circulation, it should be noted that virtually all the national central banks concerned are not in favour of continuing that tradition in view of the comparably high costs of handling very low denomination banknotes (see above).

- *“Does the ECB not support the view that the issue of the €1 banknote will make the value of the new currency more apparent to Europeans, in relation to other currencies (e.g. the dollar, which circulates as a banknote)?”*

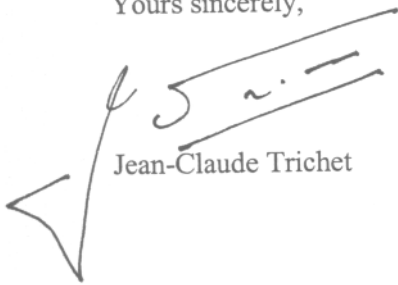
As regards the argument that banknotes with values of €1 or €2 might facilitate the use of the euro as an alternative means of payment outside the euro area, especially in countries with unstable monetary regimes, and also by tourists, it should be pointed out that the precise effects on the external demand for euro banknotes could not be quantified, and that such external demand was not evidenced in discussions with market operators. With regard to the reference to the external circulation of the US dollar, it should

be noted that, according to statistical evidence from the US Department of Treasury¹, the USD 100 banknote accounts for the largest share of US dollar banknotes circulating outside the United States.

- *"I would also like to know whether the ECB intends to re-examine the question, and, if so, when exactly? Does the ECB consider it advisable to carry out an in-depth study (assessment and repercussions) before taking further decisions?"*

In view of the above considerations, the Governing Council of the ECB decided not to issue €1 or €2 banknotes. Consequently, the denominational split will remain unchanged for the second series of euro banknotes, which is expected to be introduced towards the end of this decade.

Yours sincerely,



Jean-Claude Trichet

¹ The Use and Counterfeiting of United States Currency Abroad, Part 2: The second report to the Congress by the Secretary of the Treasury, in consultation with the Advanced Counterfeit Deterrence Steering Committee, pursuant to Section 807 of PL 104-132, March 2003.