Opinion of the Economic and Social Committee on 'An assessment of the introduction of the single currency'

(2000/C 117/05)

On 29 April 1999, the Economic and Social Committee decided, under Rule 23(3) of its Rules of Procedure, to draw up an opinion on 'An assessment of the introduction of the single currency'.

The Section for Economic and Monetary Union and Economic and Social Cohesion, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 1 February 2000. The rapporteur was Mr Sepi.

At its 370th plenary session on 1 and 2 March 2000 (meeting of 2 March), the Economic and Social Committee adopted the following opinion by 69 votes to two, with no abstentions.

1. Introduction

1.1. It may seem premature to draw up an opinion only months after the launch of the euro, and doubtless the short interval will not permit an exhaustive evaluation of the structural impact of monetary policy in the Eurosystem. However, given public interest in euro-related matters, this report meets a widely felt need. The aim is also to develop a methodology for future use.

1.2. The two meetings with the president of the ECB [1] were very important and helped to give a clearer and more detailed insight into the broad thrust of monetary policy. In the Committee's view, these meetings are very useful for analysing the issues and establishing an on-going dialogue between the Central Bank and civil society organisations. It is therefore hoped that the dialogue will continue in the form that proves most useful.

1.3. As for the method used, an analysis is needed of monetary trends, such as credit and interest rates for instance. However, the Committee is primarily interested in the role of monetary policy in the development of elements in the real economy such as employment, GDP, industrial output and exports.

1.4. Special attention must also be given to the euro and its exchange rate, with the dollar in particular, and to the possible consequences of its growing importance as a reserve currency.

1.5. The third strand in the analysis concerns institutional issues: the relationship between the Commission, the Council of Ministers, the European Parliament, the Economic and Social Committee and the ECB, and between the ECB and the national bodies governing the banking and finance sector.

(1) On 11 November 1997 and 30 June 1999.

2. The economic climate in the euro area and the ECB's view of monetary policy

2.1. The monthly bulletins issued by the ECB provide very useful information on the economic climate and, in particular, on monetary trends.

2.2. Following the decision in April to cut the interest rate on refinancing operations, it remained stable at 2,5 %. The interest rates on deposit and marginal lending facilities were at 1,5 % and 3,5 % respectively.

2.3. On 4 November, the ECB decided, however, to raise the refinancing rate by 50 basis points, bringing it back up to 3 %.

2.4. It would appear that the economy is now recovering from the sluggishness of the first few months of 1999, though the signs of recovery have still to be confirmed. The growth forecasts for GDP within the Community have in any case been revised upwards by the EU; the ECB believes that rather than being detrimental to recovery, this interest rate rise will provide the foundation for non-inflationary growth.

2.5. The ECB gives two basic reasons: increased liquidity (M3 aggregate) in the Eurosystem, which has settled at 6,1 % in contrast to the 4,5 % reference level set by the bank, and the upswing of certain internal price indicators

2.6. Regarding the extent of the rise, i.e. the 50 basis points, the ECB felt it was necessary, first, to give the financial markets a clear sign of the Bank's intention to maintain price stability and, second, to pre-empt the need for further more drastic measures at a later date.

2.7. The acceleration of economic growth, arising primarily from an improvement in the international climate, especially in the areas hit by crises, and a recovery in demand in the Eurosystem, should help to speed up the process of change in the business and services structure in the EURO area.

2.8. The indicators published by the ECB in recent months have been sending contrasting messages with regard to prices. On the one hand, it is reasonable to assume that national wage and deregulation policies launched at Community level might be enough to contain inflationary pressure. On the other hand, however, increases in oil prices, and also in those of the majority of other raw materials, as well as the revaluation of the dollar, give cause for concern, given the strong growth in liquidity, especially regarding its more volatile elements (banknotes and short-term credit).

2.9. The ECB considers that its monetary policy, which has also helped to reduce long-term interest rates, is doing as much as monetary policy can do to help address the economic and social problems facing the EU. In the ECB's opinion, it is up to economic and social policies to launch the structural reforms that are necessary to restart the growth of investment and reduce unemployment.

3. **The euro and the economy**

3.1. The Committee considers that price stability is an important precondition for boosting investment; a view shared by the ECB, which deserves recognition for its courageous interest rate policy.

3.2. However, in some countries, investment has been noticeably slow in picking up, in spite of an apparently sustainable level of stability and interest rates that are still very low. In the last few months (since May), long-term interest rates have picked up. In the light of weak inflation, the real level of the rates has risen. Long-term rates have reacted to international developments, and to the rise in US rates in particular (although the economic climate in the EU is quite different).

3.3. The ECB puts this delay down to a lack of flexibility in the European economy. On the grounds that business behaviour depends on highly complex evaluations, described in part by the ECB (labour supply and demand structure, incomplete integration of the financial and product market, and fierce international competition owing to market globalisation), the Committee believes that the current situation is compounded by insufficient activity in internal demand and, not least, in public investment, although it is aware that it is too early to make a definitive judgement.

3.4. The requirements of the Stability and Growth Pact have obliged all the countries to adopt restrictive wage and public spending policies; and the result has been the development of a contradiction, at least in the short term, within price stability policies, which on the one hand are a prerequisite for development, and on the other a major brake on growth in internal demand in most countries. (The foreign component of demand is relatively unimportant at European level. The countries in the euro area must therefore be more aware that foreign demand plays a secondary part.)

3.5. The question now is whether the balance between stability and development achieved under the Stability and Growth Pact is enough to trigger an upturn in the European economy, which must be driven largely from within.

3.6. The ECB justifies the increase in interest rates by trends shown by indicators within the Eurosystem, but it is surely no coincidence that the last two rate increases applied by the US Federal Reserve have been matched by similar ECB decisions.

3.7. The Committee does not intend to go into technical matters in its evaluation of the ECB's decisions, and it is not yet possible to assess its impact on the recovery. Nevertheless, it would seem appropriate to underline the fact that the price level was considerably lower than the 2 % set by the Ecofin Council and that the ECB's anticipatory move could, in addition to its positive effect on inflation, slow down the economic turnaround that had only just begun in certain countries.

3.8. The ECB's analysis looked first at trends in liquidity and then at a selection of indicators designed to show underlying inflation. A clearer definition of these indicators and their reciprocal bearing would be useful to provide greater assurances for operators and, above all, for the other institutions working to promote economic recovery in the Eurosystem.

3.9. The Committee supports the ECB's decision to play a consultative role in the European Employment Pact. It would nevertheless like to see a consultation process on employment involving all the European institutions, to reflect the scale of the problem. The macroeconomic dialogue in which the ECB intends to play a part will be of decisive importance here.

3.10. The Committee is in favour of changing economic structures to encourage an upswing. It would also , however, emphasise the value of the European social model, provided for under Article 2 of the Treaty and included among the Eurosystem's own objectives.

3.11. The ECB focuses on the need for a structural policy to trigger new growth, but the debate has not given enough weight to the potential of public investment to provide the European economy with a structural boost. The Committee sees no contradiction between a policy aimed at liberalising and privatising certain public industries and public intervention policies designed to strengthen productive structures when private input proves inadequate.

3.12. The euro will become a circulating currency in 2002. More attention must be given to technical, psychological and logistical difficulties that could upset the currency launch. The central banks should act fast to give the banking systems the support they need to cope with the change. The necessary monetary tools must be provided in advance to prevent imbalances that would have a damaging effect on consumers, distribution companies and, more generally, SMEs. The Committee intends to draft an opinion to explore this specific issue in more depth.

3.13. The position of the Member States outside the euro area varies, with the pound sterling essentially aligned to the dollar, and the other currencies mirroring the euro to greater or lesser degrees.

3.14. The Committee believes that it is important, even at this early stage, to assess the benefits of the euro in terms of exchange costs to companies and consumers, in order to ensure that Community legislation is applied as rigorously as possible. The Commission has drafted a memo on this subject and the Committee would like to see it published.

4. **The institutions and monetary policy**

4.1. The institutional position of the ESCB is unprecedented. It was established under an international treaty, has sovereignty over monetary policy, liaisons with supranational and national economic policy institutions, and is part of an historic process of economic and political integration, whose institutional framework has still to be finalised.

4.2. It could be said to represent a very bold transfer of sovereignty in a highly important area of traditional national policy, in a framework in which executive and legislative power have not yet achieved a satisfactory configuration.

4.3. The primary objective of the ESCB is to maintain price stability. Its next task is to support 'general economic policies in the Community' and further the objectives 'laid down in Article 2' of the Treaty [1].

4.4. The Committee notes that following initial teething problems, dialogue with the other institutions has begun to develop, in spite of the less than ideal circumstances created by the crisis in the Commission and the European Parliament elections.

4.5. The Treaty provides for the seat and timing of meetings. However, it is not always easy to translate the abstract provisions of the Treaty into the practicality of everyday relations, which are still not quite up to par. What is needed above all is a long-term common vision of the general objectives of Community integration. In this respect, the practice of holding periodical meetings with the European Parliament's committee on economic and monetary affairs marks a major step forward.

4.6. Furthermore, the ESCB's objectives require ECB monetary policy, the supranational institutions' market integration policy and national governments' tax policies to be permanently interlinked. Cooperation and coordination on budget policy between the governments of the Eurosystem countries is now becoming a primary requirement for monetary union. The Committee nevertheless accepts that for the time being the Stability and Growth Pact has favoured the necessary fiscal discipline and convergence.

4.7. A further institutional issue that needs clarifying is the role of the Council of Ministers in the Eurosystem and its relationship with the other institutions.

4.8. The monthly bulletins and speeches by the President and the other members of the ECB management are important channels of information for experts in the field and the other institutions. The Committee would nevertheless recommend that the ECB also focus on individual country data in its publications. An effort should probably be made to be more transparent and to provide more information for the rest of the public. In this respect, the Committee can see a significant role for itself as the link with civil society organisations, in the belief that the backing of public opinion is of vital importance to the work of the ECB.

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(1) Article 2 of the ECB statute: 'In accordance with Article 105(1) (ex 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 (ex 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 4 (ex Article 3a) of this Treaty.'

5. **Financial policy**

5.1. Trends in the euro/dollar exchange rate over the coming months will depend primarily on interest rate developments in the United States and Europe.

5.2. Meanwhile, the US financial market is bolstered not only by the dynamism of the economy, the interest rate gap and the consequent flow of financial resources towards US markets, but also by the fact that the European financial market is still too fragmented and heterogeneous in its national laws and that most domestic trade is still conducted with national currencies. Nonetheless, there have recently been encouraging developments in the integration of the euro monetary and financial markets.

5.3. In this context it might be useful to take a look at the supervision of banks, financial establishments, and also that of financial markets, currently the responsibility of the national central banks (or other special supervisory bodies), with the ECB playing only an advisory role. As the Treaty (Article 105) gives it a degree of power in this respect, the Council should look carefully into expanding the coordinating role of the ECB regarding the major European banks, with a view to effectively harmonising practice and regulations, and applying a single set of criteria.

6. **The international role of the Euro**

6.1. The ECB considers that monetary reserves in the central banks of third countries have slowly started to diversify in favour of the euro. It is reasonable to assume that there will have been no major transfers in the early months, particularly in view of the persistent trade surplus.

6.2. The rise of the euro as an international reserve currency could in any case pose problems for the world economy that would be very difficult to manage. The Committee hopes that an international agreement will be sought to help steer a peaceful course through the transition towards a significant diversification of the monetary reserves of the national banks of third countries.

6.3. There is a high risk of systemic crises on the world financial market, which could have a negative impact on the Eurosystem. For this reason, support must be given to G7-led efforts in the area of global coordination, control and supervision. In any event, in practical terms, an area of monetary stability in Europe should help to make capital markets less volatile and unpredictable.

6.4. In this context, the persistent dominance of the United States in IMF decisions should spur the European countries — starting with Eurosystem members — to speak with a single voice, particularly now that 11 of them share a single currency.

6.5. The high value of the dollar can be explained by the fact that in the last few years the trade deficit has been offset by an influx of foreign capital resulting from specific profit conditions in the US. The risk of accelerating inflation or, more generally, changes in these favourable conditions, could lead to an outflow of capital and a consequent reduction in the value of the dollar against the euro.

7. **Conclusions**

7.1. The Committee believes that the introduction of the single currency has, in just a short time, had a positive impact on the Eurosystem economy, by preventing an increase in speculation on national currencies and establishing conditions that will strengthen the European financial markets, for bonds and shares alike, and consequently bring down interest rates.

7.2. The establishment of the euro has brought a degree of stability, lessening the risk that individual countries will adopt restrictive policies to counter speculation.

7.3. With time, the single currency could provide third countries with an alternative to the dollar as a reserve currency, promote cohesion within the European Union and pave the way for a more harmonised budget policy.

7.4. The credibility of a currency always depends on expectations for the future; in the euro's case, this means expectations for the sustainable growth of the Eurosystem. The performance of the euro at international level may partly be explained by the institutional uncertainty which clouds the management of the Eurosystem economy. In the Committee's view, the starting points for enhancing the role of the euro as a world currency are stronger institutions, faster market integration and reform, and measures to lay the foundations for development.

7.5. The strength and stability of the euro will depend not only on purely monetary measures, but also, and above all, on income or economic policies to promote structural reform, employment and social cohesion. These measures should equip the Eurosystem to compete even more effectively with the world's other economic areas.

7.6. The Committee believes that the institutional dialogue launched with the ECB could play an important role as it sets the scene for better coordination between monetary policies and the objectives, needs and prospects of the European economy as a whole.

8. Latest rise in the interest rate on the main refinancing operations

8.1. The fact that over the last 20 years the rate of the ecu against the dollar has fluctuated between 1.7 and 0.6 [1], would suggest that recent trends are far from exceptional. The Americans rarely discuss the dollar quotation, and the Europeans would do well to accept variations in the euro's exchange rate. If the basic strengths of the European economy are to be translated into a more positive exchange rate movement, structural reforms in the product, service and capital markets will have to be stepped up (Cardiff process).

8.2. The European capital market must develop a better climate for new business in the more technologically dynamic areas of the economy.

8.3. The 25 basis point increase introduced by the Federal Reserve and then by the ECB beg one further comment from the Committee. The Federal Reserve decision was followed by an announcement by the US treasury secretary of a considerable debt buyback programme, meaning that the restrictive measure imposed by the monetary authority was largely offset by the treasury's liquidity injection. This would not have been possible in the Eurosystem, where, in the absence of a single body to govern the economy (or a treasury secretary), the ECB is alone in determining the system's liquidity.

(1) See article in the *Wall Street Journal* of 28 January 2000.

Brussels, 2 March 2000.

The President

of the Economic and Social Committee

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