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REPORT

on the European Central Bank recommendation for a Council Regulation (EC) concerning further calls of foreign reserve assets by the European Central Bank
(BCE 0001/1999 – C5-0202/1999 – 1999/0817(CNS))

Committee on Economic and Monetary Affairs

Rapporteur: Robert Goebbels

Symbols for procedures		***Abbreviations for committees***		
*	Consultation procedure *majority of the votes cast*	I.	AFET	Committee on Foreign Affairs, Human Rights, Common Security and Defence Policy
**I	Cooperation procedure (first reading) *majority of the votes cast*	II.	BUDG	Committee on Budgets
**II	Cooperation procedure (second reading) *majority of the votes cast, to approve the common position* *majority of Parliament's component Members, to reject or amend the common position*	III.	CONT	Committee on Budgetary Control
***	Assent procedure *majority of Parliament's component Members except in cases covered by Articles 105, 107, 161 and 300 of the EC Treaty and Article 7 of the EU Treaty*	IV.	LIBE	Committee on Citizens' Freedoms and Rights, Justice and Home Affairs
***I	Codecision procedure (first reading) *majority of the votes cast*	V.	ECON	Committee on Economic and Monetary Affairs
***II	Codecision procedure (second reading) *majority of the votes cast, to approve the common position* *majority of Parliament's component Members, to reject or amend the common position*	VI.	JURI	Committee on Legal Affairs and the Internal Market
***III	Codecision procedure (third reading) *majority of the votes cast, to approve the joint text*	VII.	INDU	Committee on Industry, External Trade, Research and Energy
(The type of procedure depends on the legal basis proposed by the Commission)		VIII.	EMPL	Committee on Employment and Social Affairs
		IX.	ENVI	Committee on the Environment, Public Health and Consumer Policy
		X.	AGRI	Committee on Agriculture and Rural Development
		XI.	PECH	Committee on Fisheries
		XII.	REGI	Committee on Regional Policy, Transport and Tourism
		XIII.	CULT	Committee on Culture, Youth, Education, the Media and Sport
		XIV.	DEVE	Committee on Development and Cooperation
		XV.	AFCO	Committee on Constitutional Affairs
		XVI.	FEMM	Committee on Women's Rights and Equal Opportunities
		XVII.	PETI	Committee on Petitions

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PROCEDURAL PAGE

By letter of 14 October 1999 the Council consulted Parliament, pursuant to Article 107(6) of the EC Treaty, on the European Central Bank recommendation for a Council Regulation (EC) concerning further calls of foreign reserve assets by the European Central Bank (BCE 0001/1999 - 1999/0817 (CNS)).

At the sitting of 25 October 1999 the President of Parliament announced that she had referred this proposal to the Committee on Economic and Monetary Affairs as the committee responsible (C5-0202/1999).

The Committee on Economic and Monetary Affairs appointed Robert Goebbels rapporteur at its meeting of 25 October 1999.

It considered the Commission proposal and draft report at its meetings of 27 January 2000 and 23 February 2000.

At the last meeting it adopted the draft legislative resolution by 24 votes to 6, with 2 abstentions.

The following were present for the vote: Christa Randzio-Plath, chairman; José Manuel García-Margallo y Marfil and Ioannis Theonas, vice-chairmen; Robert Goebbels, rapporteur; Armonia Bordes, Hans Udo Bullmann, Renato Brunetta (for Staffan Burenstam Linder), Ieke van den Burg (for Richard A. Balfe), Martin Callanan (for Alain Madelin), Jonathan Evans, Göran Färm (for Simon Francis Murphy), Ingo Friedrich (for Alejandro Agag Longo), Carles-Alfred Gasòliba i Böhm, Christopher Huhne, Ulpu Iivari (for Pervenche Berès pursuant to Rule 153(2)), Juan de Dios Izquierdo Collado (for Luis Berenguer Fuster), Pierre Jonckheer, Othmar Karas, Giorgos Katiforis, Piia-Noora Kauppi, Werner Langen (for Astrid Lulling), Marie-Noëlle Lienemann (for Peter William Skinner), Alain Lipietz, Thomas Mann (for Karl von Wogau), Ioannis Marinos, Mihail Papayannakis (for Fausto Bertinotti), Karla M.H. Peijs (for Christoph Werner Konrad), Fernando Pérez Royo, Giovanni Saverio Pittella (for Bruno Trentin pursuant to Rule 153(2)), José Javier Pomés Ruiz, John Purvis (for Amalia Sartori), Alexander Radwan, Bernhard Rapkay, Karin Riis-Jørgensen, Olle Schmidt, David Sumberg (for Marianne L.P. Thyssen pursuant to Rule 153(2)), Charles Tannock, Helena Torres Marques and Theresa Villiers.

The report was tabled on 23 February 2000.

The deadline for tabling amendments will be indicated in the draft agenda for the relevant part-session

LEGISLATIVE PROPOSAL

Recommendation for a Council Regulation (EC) concerning further calls of foreign reserve assets by the European Central Bank (BCE 0001/1999 – C5-0202/1999 – 1999/0817(CNS))

The proposal is approved.

DRAFT LEGISLATIVE RESOLUTION

European Parliament legislative resolution on the European Central Bank recommendation for a Council Regulation (EC) concerning further calls of foreign reserve assets by the European Central Bank (BCE 0001/1999 – C5-0202/1999 – 1999/0817(CNS))

(Consultation procedure)

The European Parliament,

– having regard to the European Central Bank recommendation to the Council (BCE 0001/1999[1]),

– having been consulted by the Council pursuant to Article 107(6) of the EC Treaty (C5-0202/1999),

– having regard to Rule 67 of its Rules of Procedure,

– having regard to the report of the Committee on Economic and Monetary Affairs (A5-0042/2000),

1. Approves the European Central Bank recommendation ;

2. Calls on the Council to notify Parliament should it intend to depart from the text approved by Parliament;

3. Asks to be consulted again should the Council intend to amend the European Central Bank recommendation substantially;

4. Instructs its President to forward Parliament's position to the Council, Commission and European Central Bank.

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[1] OJ C 269, 23.9.1999, p.9.

EXPLANATORY STATEMENT

1. Political basis

As was the case with the recommendation submitted by the ECB on 3 November 1998 on capital increases for the European Central Bank (endorsed on 14 April 1999 by the European Parliament), this recommendation seeks to enhance the financial independence needed by an institution whose political independence is what is sought by Article 7 of the Treaty. ECB independence in that respect is in fact the keystone of the Eurosystem and of the Union's political objective: safeguarding price stability. By having the ceiling for its calls of foreign reserve assets raised from EUR 50 bn to EUR 100 bn, the ECB will gain in not only financial independence, but, above all, credibility, in particular as regards its ability to adapt to different possible scenarios. The euro will be called upon to play an increasingly important role in the international financial system. The latter's potential instability does not need to be demonstrated, given the recurring financial crises in recent years. As the guardian of the euro and of the stability policy underlying what the Union is seeking in terms of economic and monetary actions the ECB must have the means to realise this European ambition.

2. Legal basis for the holding of reserves

Holding and managing the official foreign reserves of the Member States is one of the 'tasks' of the European System of Central Banks (ESCB) as laid down by Article 3 of the ESCB Statute, the ESCB being defined in Article 1.2. of its Statute as being 'composed of the ECB and of the central banks of the Member States ('national central banks')'.

The task of holding and managing the Eurosystem reserves is carried out jointly by the ECB and the national central banks (NCB) in as much as Article 30.1. of the Statute provides for only a partial transfer of NCB foreign reserve assets to the ECB 'up to an amount equivalent to ECU 50 000 million'.

Article 30.2. of the Statute stipulates that the scale for the contributions of the NCB is the same as that used for their share of the ECB capital. Although the ESCB is not a legal entity, unlike the ECB, Article 26.3. of the Statute provides for publication of consolidated financial accounts: 'For analytical and operational purposes, the Executive Board shall draw up a consolidated balance sheet of the ESCB, comprising those assets and liabilities of the national central banks that fall within the ESCB'. The NCB therefore retain possession of the assets and liabilities resulting from the operations they carry out in accordance with ECB guidelines and instructions under the Eurosystem.

3. Legal context of the EP consultation process in progress

Article 107(6) of the Treaty lays down that a series of ESCB-related provisions must be the subject of complementary legislation (Regulation or Decision) adopted by the Council acting by a qualified majority. The Statute provisions set out (Articles 4, 5.4., 19.2., 20, 28.1., 29.2., 30.4. and 34.3.) concern, respectively, the ECB's advisory functions, reporting requirements, minimum reserves and other possible monetary policy instruments, capital increases, statistical data, further foreign reserves, and the ECB's powers to impose penalties.

In accordance with Article 42 of the Statute, the Council made a start on adopting some of these provisions 'immediately after the decision on the date for the beginning of the third stage', but the groundwork needed for some has been more protracted than for others. Parliament's opinions on several regulations were delivered in 1998 and 1999.

The text submitted to Parliament is a draft; it was still under discussion within the Economic and Financial Committee in December 1999. This regulation will not be adopted until Parliament and the Commission have been consulted, but the Council may disregard their opinions (assent not being necessary).

The Council acts by qualified majority either on a proposal from the Commission and after consulting the European Parliament and the ECB or, as in this instance, on a recommendation from the ECB and after consulting the European Parliament and the Commission.

The NCB percentage shares in the capital of the ECB are determined on the basis of the GDP and population statistics notified by the Commission and apply to NCB contributions to ECB reserves (Article 30.1. of the Statute).

This weighting also applies to the votes of the Governors of the 11 NCB when the ECB Governing Council takes decisions with financial implications for the institution on the basis of Articles 28, 29, 30, 32, 33 and 51 of the Statute; the votes of the six members of the Executive Board are zero-weighted (Article 10.3. of the Statute). This was the case when the ECB Council adopted the recommendation under consideration.

The contributions of the central banks of the four Member States with a derogation – to either capital or foreign reserves - have not been called up, which means that, of a potential total of EUR 50 bn, the reserves actually pooled by the 11 participating NCB amount to only EUR 39.5 bn: 85% in foreign reserves (mainly US dollars) and 15% in gold.

4. <u>Why, and on the basis of what arrangements, would there be increases in reserves?</u>

- One formal reason, to start with, is that the Treaty makes provision for it: failure to apply the provision and failure to adopt a regulation on this issue only could be construed as indicating disagreement between the European Central Bank and the Council.

- Another reason, cited in the explanatory memorandum accompanying the draft regulation, is to ensure the ECB's financial equilibrium over the medium term: 'to enhance the necessary financial independence of the ECB', i.e. to enhance the income derived from its assets so as to prevent it from losing any credibility with, or dependence on, its shareholders in the event of an operating deficit.

  The income from the capital currently paid up and from official reserves is presently the only source of revenue for the ECB; this is supposed to make it self-supporting, i.e. finance its infrastructure, staff and operations. Profit derived by the ECB is either assigned to the reserves or paid out to the NCB. Any loss is offset against the ECB's general reserve fund and, if necessary, following a decision by the Governing Council, against the NCB monetary income (Article 33.2. of the ECB Statute).

Over the period from 1 June to 31 December 1998, the net interest income accruing to the ECB was EUR 95 m, of which 68 m was used to run the institution (30 m on staff costs, 30 m on other administrative costs and 8 m to offset asset depreciation). The EUR 27.5 m profit was retained by the ECB. Depending on financial market trends, that profit may easily be eroded.

Although the balance sheet for 1999 is not yet available, the ECB is likely to have made a loss in that financial year. That loss will be offset against the general reserve fund set up in 1998 and against existing mechanisms. (The monetary income of the Eurosystem may be retained in part or in full by the ECB, i.e. the income accruing from bank deposit surpluses in connection with minimum reserves and the remuneration differential on marginal deposit facilities, income derived from the issue of national banknotes not being pooled.) Ultimately, however, such a situation is not healthy, and a central bank with a structural deficit would simply not be credible.

Should the political authorities – Parliament and the Council – refuse to help to bring about a structural improvement in the financial position of the ECB, the latter would no longer be regarded as independent by the markets.

A lack of sufficient income in the medium term would prevent the ECB from developing its activities and from making its monetary policy even more transparent and, hence, more credible.

We would point out that the ECB was recently authorised to increase its staff from 750 to 1000 in 2000, which will have significant budgetary implications. An ECB staff 1000 strong should be contrasted with the some 60 000 staff working for the 15 NCB, the 23 000 staff of the Federal Reserve System and the 6000 staff at the Bank of Japan.)

The recommended increases in both capital and foreign reserves will not impoverish the NCB; rather, for the NCB, they constitute alternative assets, given that they are the ECB's shareholders. Furthermore, the NCB will still have own official reserves of close to EUR 300 bn.

The option of effecting further calls of foreign reserves would enable the ECB, if need be, to store its capacity to intervene on the foreign exchange markets.

- This is in fact the third, and possibly the most fundamental, objective of the recommendation, i.e. to make the foreign exchange intervention instrument more credible and foster the ECB's capacity to adjust to various scenarios.

The explanatory memorandum indicates that the initial limit of EUR 50 bn is appropriate for the time being, but that it might cease to be so 'once the possible needs of the ECB have been more clearly established'.

What this involves, as in the case of the draft Council regulation on capital increases, is simply authorisation in principle to enable action to be taken accordingly, as needed, without being pressurised to do so by exceptional events.

The ECB will not necessarily double its reserves in the near future, but, for example, might make use of this procedure to augment them on a case-by-case basis, by up to EUR 39.5 bn, during a period of large-scale intervention in particular, but also, possibly, because of potential portfolio losses (the portfolio being revalued every quarter according to market rates).

It should be noted that, in CEPS Working Paper No 128 (March 1999), Daniel Gros and Franziska Schobert maintain the following:

'It is (...) difficult to estimate the optimum level of foreign exchange reserves for countries or areas such as the euro zone which tend to have a very open market. They might desire a certain level of reserves not for actually using it in interventions, but rather to have a 'war chest' for potential speculative attacks. (...) We would argue that foreign exchange reserve of about 100 billion euro (twice the minimum amount foreseen under the Maastricht Treaty) should be enough.'

Your rapporteur can therefore but recommend that the European Parliament endorse the ECB proposal to double the ceiling laid down for official foreign exchange reserves.

The option of effecting further calls will be definitively established when the regulation under consideration is adopted. Any calls on reserves will take the forms of ECB Council decisions taken in accordance with the above-mentioned majority-voting rules provided for by Article 10.3.

Given the lack of detail in the draft regulation, it seems that the ECB Council would be able to decide whether or not to publish them, depending on the circumstances. In the event of market tensions, such discretion is legitimate and warranted. Vis-à-vis the markets, no-one claims that the deterrent effect of the foreign exchange intervention instrument is proportional to the amount of reserves. However, credibility is enhanced by the option of being able to mobilise additional assets at any time without delay.

The ECB's hitting power will be enhanced by the unpredictable, discretionary and confidential nature of any further calls of reserves.

It would be warranted, however, for such internal ESCB transfers, which will not be included in the Eurosystem's weekly consolidated financial statements, to be disclosed *a posteriori*.

Parliament also assumes that the ECB President will explain the decisions taken by his Council when he appears before the Committee on Economic and Monetary Affairs and, indeed, during plenary debates.

5. Accounting transparency of foreign exchange operations

The Eurosystem reserves appear on the assets side of the weekly financial statement (monetary balance sheet), which is presented as levels outstanding: variations in levels outstanding from one week to the next for each line are calculated and presented in the column entitled 'Difference compared to last week due to transactions', but they do not allow conclusions to be drawn as to any interventions carried out.

The ECB points out that the visible variations in the items concerned stem not only from the impact of any foreign exchange interventions, but also from other factors, in particular foreign exchange operations carried out on behalf of governments and other public entities by the NCB.

For the time being, reporting on foreign exchange operations is not planned. The Federal Reserve however, produces a quarterly report, *a posteriori*, on foreign exchange operations (whether or not there have been any). In the interests of transparency, Parliament calls for the ECB to do likewise in the near future.

6. Conclusions

Authorising the ECB's Governing Council to increase the ECB capital and foreign reserves is the best solution for ensuring that the ECB is financially independent and in a position to carry out its tasks appropriately.

An increase in paid-up capital would enable the necessary income to be generated to cover the funding requirements of the ECB and will serve to consolidate its credibility and independence.

The option of effecting further calls of foreign reserves would enable the ECB, if needed, to enhance its capacity to intervene on the foreign exchange markets.