The role of the European Monetary Institute

The European Monetary Institute (EMI) is the chief institutional innovation of the second stage of Economic and Monetary Union (EMU) which began on 1 January 1994. This article is concerned with what the Maastricht Treaty says about the role of the EMI. It examines the EMI's mandate, the part it will play in co-ordinating the work of the national central banks, its responsibilities for preparing for Stage 3 of EMU and its other advisory and operational functions. A box gives additional details on the organisation of the EMI.

Introduction

The European Monetary Institute was established on 1 January; it is one of the most tangible manifestations of the Maastricht Treaty, which came into force on 1 November 1993. Its primary legal basis is Article 109f of the Treaty and the Protocol on the Statute of the European Monetary Institute annexed to it. These provisions have since been fleshed out by secondary legislation covering various aspects of the EMI's organisation, functions and funding.

The senior decision-making body of the EMI is its Council, which comprises a full-time President (the first President is Alexandre Lamfalussy, previously General Manager of the Bank for International Settlements) and the Governors of the Central Banks of the Member States, one of whom (Maurice Doyle, governor of the Central Bank of Ireland) has been appointed Vice-President.

The EMI is still very much in embryonic form. The decision to locate it in Frankfurt was taken only in late October 1993 and, for the time being, many of its activities will be conducted from Basle, the home of the main institution to which the EMI is successor, the Committee of EC Central Bank Governors. The Institute will move to Frankfurt later in 1994.

The transition from Stage 1 to Stage 2 of EMU is an evolutionary change rather than a radical break. In the same way, the role of the EMI extends and formalises that of the Committee of Governors. But there are some potentially significant differences. First, the EMI is explicitly working in the context of an eventual move to the third stage of economic and monetary union, whereas the Committee of Governors had a looser remit as a forum for discussing issues of common interest to EC central banks. Second, the scope of the EMI's activities runs somewhat wider. And third, as an institution whose functions are specified in the Treaty, the EMI has legal personality and is explicitly required to be independent of individual Member States and of other Community bodies.

The EMI's mandate

The Treaty (Articles 109f2,3) charges the EMI with:

- strengthening co-operation among the national central banks;
- strengthening the co-ordination of monetary policies with the aim of ensuring price stability;
- monitoring the functioning of the European Monetary System (EMS);
- preparing for the third stage of Economic and Monetary Union;
- holding consultations on issues falling within the competence of national central banks and affecting the stability of financial institutions and markets;
- taking over the tasks of the European Monetary Co-operation Fund (EMCF), which was responsible for managing operations relating to the EMS; and
- facilitating the use of the ECU and overseeing its development.

The EMI Protocol (Article 3.1) makes clear that responsibility for monetary policy remains squarely in the hands of national authorities. The EMI's role is essentially therefore to co-ordinate and advise. It will also, however, have a limited operational role in relation, for example, to the Very Short-Term Financing facility. This may in due course expand if Member States choose to take advantage of the provision in the Protocol (Article 6.4) which allows the EMI to hold and manage foreign exchange reserves on an agency basis.

Promoting monetary and financial stability

Like the Committee of Governors, the EMI will provide an institutional framework for central bank co-ordination. The primary goal of such co-ordination is price stability.[1] But the stability of the European financial system also falls

[1] Article 109f2.

within the EMI's area of concern. With the increasing integration of national markets within the Single Market framework, this is at times likely to involve cross-border questions which need to be addressed at a European level.

The EMI's President and permanent staff will be able to express their views in several ways: in discussions with national central bank governors during the regular Council meetings; in their assessment of the monetary and financial state of the Community included in the EMI's annual report; and in specific recommendations to the national monetary authorities about their conduct of policy (the EMI Council can make these recommendations public if all its members agree). Through its monitoring role, by recommending policy changes where they appear necessary, and by increasing the transparency of policy-making on a European Union-wide (EU) basis, the EMI should be able to contribute to robust counterinflationary monetary policies across the Union.

The EMI's activities will, in part, run in parallel with the multilateral surveillance of national economic policies which will be conducted by ministers in the Council of Economic and Finance Ministers (ECOFIN). Much of this will take place within the 'broad guidelines' process, which identifies common goals for economic policy in the Member States. The first set of these guidelines was adopted by ECOFIN last December under the provisions of Article 103 of the Treaty.

Preparing for Stage 3

Another of the EMI's key responsibilities is to pave the way for economic and monetary union. To the extent that they promote convergence, the EMI's other activities contribute to achieving this goal. But the EMI is also assigned some more specific functions with this end in view.

The first is its mandate to draw up a framework for the operation of monetary policy within the European System of Central Banks (ESCB) in Stage 3. Article 109f3 and EMI Statute Article 4.2 describe the areas on which the EMI is expected to focus. They include the instruments and procedures for the conduct of monetary policy in Stage 3, and the rules governing the relationship between the national central banks and the European Central Bank (ECB) within the ESCB. The EMI also has the task of promoting the harmonisation of statistical definitions and procedures (in so far as this is necessary for the conduct of a single monetary policy in Stage 3); and of overseeing the technical preparation of ECU banknotes for Stage 3. Lastly, the EMI is required to prepare, by 31 December 1996, a comprehensive regulatory, organisational and logistical framework within which the ESCB would operate; this would be adopted by a vote of the ECB Council.(1)

The second area where the EMI has a direct role in preparing for Stage 3 is in the formal convergence assessment process which must precede any move to EMU. There are four main criteria by which Member States' suitability for economic and monetary union will be judged.(2) Broadly speaking, they involve convergence on low inflation rates, the avoidance of excessive deficits, participation in the ERM within the 'normal' fluctuation margins for at least two years, and long-term interest rate differentials that reflect the durability of convergence.

In this context, the EMI will submit each year a report to ECOFIN on the state of preparations for Stage 3. These reports will include an assessment of the progress towards convergence in the Union, and cover in particular the adaptation of monetary policy instruments and the preparation of the framework for monetary policy in Stage 3.(3) In addition, before the end of 1996, the EMI and the Commission will independently prepare reports for ECOFIN, in which they will assess each Member State's progress against the four convergence criteria. These two reports will take into account related factors such as unit labour costs, other price indices, Member States' balance of payments, the development of the ECU, and the integration of the Single Market. The reports will also examine issues such as the statutes of each Member State's central bank. National central banks must meet the definition of independence set out in the Treaty by,(4) at the latest,(5) the date on which the Member State is to begin participating in the monetary union.

Consultation on draft legislation

Under Article 109f6 of the Maastricht Treaty, ECOFIN or any national authority preparing 'draft legislative provisions' within the EMI's field of competence must consult the Institute. Secondary Community legislation (a Council Decision) has been adopted to flesh out this requirement.(6)

This consultation procedure is intended as a structural counterpart to economic and monetary convergence, by helping to make the institutional and legal frameworks in the Member States more compatible. The Council Decision on consultation defines the EMI's field of competence partly in terms of the areas in which some form of harmonisation before Stage 3 would be desirable. It also includes various safeguards against excessive consultation. First, according to Article 2 of the Decision, a draft legislative provision must be both legally binding and of general applicability for it to be considered by the EMI. Second, the Decision allows the EMI to comment on whether it believes any draft provisions submitted to it fall within its field of competence. And third, national authorities are not required to consult the

(1) Before the move to Stage 3, should it take place, and thus the EMI's replacement by the ECB, the Institute does have one final task. That is to give an opinion on the Council's candidates for appointment to the Executive Board of the ECB, for endorsement by the European Parliament and appointment by the Council (meeting at the level of heads of state or government).
(2) These are laid down in Article 109j1 and the Protocol on the Convergence Criteria annexed to the Treaty.
(3) Article 7 of the EMI Statute.
(4) Article 107.
(5) According to Article 108.
(6) Council Decision No 9459/93 on the consultation of the European Monetary Institute by the authorities of the Member States on draft legislative provisions.

The organisation of the EMI

The European Monetary Institute is recognised under EU law as an EU body. Internal organisational matters—with a few exceptions, such as the appointment of the President and the site of the head office—are left to the EMI's management.

The senior decision-making body of the EMI is the EMI Council. This comprises the President of the EMI and the Governors of the national central banks (one of whom is designated the EMI's Vice-President). Its independence from the influence of Member States or other Community organisations is guaranteed in Article 8 of the EMI Statute. The President of ECOFIN and a member of the European Commission have the right to participate—without voting—in EMI Council meetings, which will take place at least ten times a year.

The EMI has the power to issue several types of legally recognised proclamations: Opinions, Recommendations, Guidelines and Decisions. Opinions and Recommendations—which largely relate to national policy actions—are not legally binding on those to whom they are addressed. Nor are the Guidelines for a monetary policy framework for Stage 3 which the EMI must draw up; before they become binding, they would have to be approved by the European Central Bank. On the other hand, Decisions by the EMI—which for the most part will be concerned with organisational and procedural matters—are legally binding, with the proviso that they do not compromise Article 3.1 of the EMI Statute which affirms that monetary policy is the sole responsibility of the national authorities.

The President of the EMI is chosen via a political process. A candidate is recommended by the EMI Council and confirmed by the European Council; the European Parliament is also consulted. It is a full-time position, and entails preparing and chairing the meetings of the EMI Council and representing the EMI's view externally. To co-ordinate the EMI's work with that of the Council of Ministers, the President of the EMI can be invited to those Council meetings which discuss matters relevant to the EMI. The EMI will also have a chief executive responsible under the President for the Institute's day-to-day management.

Supporting the EMI Council is a permanent staff. At present it is based on the former Committee of Governors' Secretariat, but its number will increase when the EMI moves to Frankfurt. It is expected, at least initially, that the majority of professional staff will be seconded from national central banks, but the EMI may also recruit independently. Although the United Kingdom has reserved the right to opt out of Stage 3, it will play a full part in Stage 2 and the Bank of England has already sent staff to work in the EMI. The permanent staff will prepare the meetings of the EMI Council, and fulfil the EMI's day-to-day responsibilities of co-ordination, oversight and consultation within the EMI's sphere of interests. The EMI has inherited a network of subcommittees and working groups from the Committee of Governors which tap into central banks for their membership and wider support. This arrangement is likely to continue, at least in the near future.

The EMI is funded by the national central banks, rather than Member States, according to Article 16.2 of the EMI's Statute and the secondary legislation on the EMI Key for determining financial contributions. This arrangement reflects the need for the EMI to be independent of EU institutions and national governments. The EMI Key is determined on the basis of two factors, equally weighted. These are 1992 population and GDP at market prices averaged over the five years up to and including 1991. On this basis, the United Kingdom's share would be around one sixth, a little less than those of Germany, France and Italy. Under Article 16.1, the Council of the EMI determines the necessary size of the Institute's resources.

The EMI will be accountable for its actions in various ways:

(i) its annual report provides an opportunity for public scrutiny. This report will detail the EMI's activities and is to be addressed to the European Parliament, the Council of Ministers, the European Council and the Commission. In this context, the President of the EMI is likely to appear before the Economic and Monetary Affairs Committee of the European Parliament;

(ii) the European Court of Justice has the power, under Article 19 of the EMI Statute, to review the acts and omissions of the EMI;

(iii) the EMI's shareholders— the national central banks—will supervise the EMI's activities on a regular basis, not least at EMI Council meetings; and

(iv) Article 17.3 of its Statute makes clear that the EMI's annual accounts are to be published and audited by independent external auditors; under Article 27.2, its management will also be monitored by the European Court of Auditors.

EMI in cases where legislation merely transposes Community Directives into national law, because the EMI will already have been consulted by ECOFIN when the draft Directive was negotiated.

The EMI is required to deliver Opinions on the proposed 'draft legislative provisions' it receives from national authorities. These Opinions are not binding on the authorities, and must be delivered within a period set by the national authorities—though the EMI cannot be obliged to respond in less than one month, except in cases of extreme urgency. But should the EMI not meet the deadline, the national authority can nevertheless proceed.

Facilitating the use of the ECU

The Treaty gives the EMI responsibility for the ECU(1) in two ways. It requires it to facilitate the use of the ECU in the financial markets, and to ensure that the ECU clearing system functions smoothly. These tasks will in part be carried out through the medium of the national central banks; but the EMI as an institution will be able to co-ordinate their activities, advise on areas of concern, and suggest remedies.

The EMI's principal task will be to assist the market development of the ECU, rather than guide it. Indeed, the ECU has already developed organically with some success. Many instruments in many financial markets are already denominated in ECUs; several central banks use such market instruments in their management of official foreign exchange reserves; and they also play a role in financing government deficits in some Member States. The EMI's role in practice will be to monitor and promote regulatory and other developments, in the Member States and at the Community level, that reinforce the status of the ECU.

The EMI's operational role

The EMI has several operational tasks in addition to its policy co-ordination and consultative roles. Many relate to the functioning of the EMS. These were inherited from the EMCF, and include responsibility for the Very Short-Term Financing mechanism (VSTF), and the administration of the Medium-Term Financial Support facility (MTFS). The VSTF is the mechanism by which central banks borrow from each other at short notice in order to finance intervention in the ERM. It has been extensively used, for example, during the upheavals in the foreign exchange markets in the last two years. The MTFS is the technical instrument by which the EU Council provides financial support to a Member State facing balance of payments difficulties.

As successor to the EMCF, the EMI also receives, as part of the EMS agreement, monetary reserves from the national central banks, which are credited with a corresponding amount of ECUs in the EMI's books in the form of three-month renewable swaps. By the same token, the EMI may grant to the monetary authorities of third countries and to international monetary institutions the status of 'other holders of ECU'. When taking decisions in these areas, the EMI Council must act by consensus (formally, unanimous voting is required).

One area in which the EMI's operational role may develop beyond that of the EMCF is in the field of foreign exchange reserve management.(2) The EMI will only be able to act in a strictly limited capacity, as the agent of a national central bank; and national central banks are not obliged to provide reserves for the EMI to manage. The rules governing this agency function have to be specified in an EMI Decision, and so would be legally binding. As Article 6.4 of the Statute states, the rules must ensure that this function does not compromise the sovereignty of Member States in monetary and exchange-rate policy.

Conclusion

When he was being questioned by the European Parliament's Economic and Monetary Affairs Committee, the EMI's President was asked to explain how he saw the EMI 'adding value'. He replied that its contribution would be twofold. The Institute would act as an honest broker in the process of European economic and monetary co-operation—in essence, a facilitator of the convergence process. But it would also serve as a source of ideas for addressing the knottier monetary and exchange-rate policy issues facing European integration.

Several issues have recently arisen which may be addressed in this way. Indeed, while preparing for Stage 3 of EMU remains one of the EMI's key objectives, other items have moved up its prospective agenda since the Treaty was signed. In particular, the move to wide bands within the ERM raises the question of how best now to pursue the objective of price stability. The EMI is well placed to consider such issues. And by doing this within the policy-making framework for Stage 2, the EMI will be furthering much of the work which the Committee of Governors had initiated during Stage 1.

(1) The European Currency Unit, the ECU, as used in financial markets is normally defined by reference to the currency basket used in the EMS. The actual value of the ECU in financial markets may diverge from this notional value according to the supply and demand for the unit relative to the component currencies in the basket.
(2) This is provided for in Article 6.4 of the EMI Statute.