Recent institutional developments in economic and monetary cooperation

Economic and monetary cooperation relies on what has become a very extensive network of international and European organisations and bodies. The Bundesbank plays an important role within the context of this institutionalised cooperation. Over the years, its special publications have therefore contributed to encouraging as much transparency as possible in the tasks and activities of important organisations and bodies in which it participates directly or which are of particular interest to it. Recently, the number of important international and European bodies which are relevant to the Bundesbank has increased further. At a global level the Financial Stability Forum and the Group of Twenty are the main new developments. In Europe, the Eurogroup of economics and finance ministers was formed in the wake of European Monetary Union. Furthermore, several committees have been set up to act as coordinating instruments within the European System of Central Banks. The International Relations Committee plays a special role here because it mainly addresses international issues, thus representing one stage in the process of global cooperation. To supplement the Bundesbank's special publications on international organisations and bodies, this article describes the aforementioned recent developments in detail.

An overview of the current institutional framework

Extensive institutional cooperation

Since the Second World War there has been an unexpected intensification of economic and monetary cooperation. Taking the world economy as a whole, there are today five global international organisations which can be seen as the most important vehicles for this cooperation. The International Monetary Fund (IMF) is responsible for the stability of the international monetary system. It has primarily a disciplinary influence on the economic policy of its members and is able to grant conditional emergency credit in the case of balance of payments difficulties. The World Bank Group provides financial and technical support as a means of encouraging the process of economic and social catching-up in developing countries. The World Trade Organisation (WTO), the successor of the General Agreement on Tariffs and Trade (GATT), deals with the liberalisation of the movement of goods and services, the protection of intellectual property rights and the combating of unfair trading practices. The Bank for International Settlements (BIS) works to promote cooperation between central banks in all spheres of activity and has also become the international centre for cooperation among banking supervisors. Finally, there is the Organisation for Economic Co-operation and Development (OECD), which was initially the driving force behind the liberalisation of the movement of goods and capital in industrial countries and – with the world economy becoming more globalised – today mainly tackles structural policy problems of its member states. This formal cooperation in the field of economic and monetary policy is supplemented by informal cooperation within the framework of the Group of Seven (G7) and the Group of Ten (G10). In addition, the European Union (EU) is of prime importance for Europe. By dismantling trade barriers and removing all restrictions with regard to production factors, the EU countries have formed a single market. In addition, some policy areas have been subordinated to a common responsibility. With the introduction of the euro, monetary policy sovereignty, in particular, shifted to the European level; meanwhile, the integration of the product and financial markets is being driven by the single currency.[1]

The FSF and the G20 supplement existing worldwide mechanisms

In 1999 two further informal bodies in which the Bundesbank participates were added to the already numerous mechanisms for international cooperation. These are the Financial Stability Forum (FSF), which owes its existence to a proposal made by the former President of the Bundesbank, Hans Tietmeyer,[2] and the Group of Twenty (G20), which, in contrast to the G7 and G10, also includes important emerging markets.

In addition, European Monetary Union has led to enhanced cooperation between the euro area governments. The newly estab-

1 Details of all mentioned organisations and bodies can be found in the following special publications by the Deutsche Bundesbank (available in German only): *Weltweite Organisationen und Gremien im Bereich von Währung und Wirtschaft, April 1997; Europäische Organisationen und Gremien im Bereich von Währung und Wirtschaft,* May 1997.
2 The proposal forms part of a report addressed to the G7 finance ministers and central bank governors, published in: Deutsche Bundesbank, Monthly Report, May 1999.

The Eurogroup and the IRC as important additional coordination bodies in European Monetary Union

lished informal Eurogroup of economics and finance ministers works to this end. In addition, the establishment of the European Central Bank (ECB) has resulted in close cooperation between itself and the national central banks participating in the European System of Central Banks (ESCB). This cooperation relies on the support of a total of 13 key committees on which, in addition to the Eurosystem (the ECB and the national central banks of the euro area countries), representatives of the other EU central banks serve if the topics under discussion fall within the competence of the General Council of the ECB or are of general interest. The International Relations Committee (IRC) plays a special role in that it deals mainly with international issues and – as far as is necessary or expedient – develops common positions.

Recent developments at the international level

Initial experiences with the FSF

Members, tasks and working patterns

As shown by the international financial crises of the 1990s, if balance of payments problems occur, a crisis can be seriously exacerbated by shortcomings in the financial systems of emerging markets. For example, countries whose banks had little equity capital but a large number of unreliable borrowers and considerable short-term foreign currency liabilities were hit twice over in a crisis of confidence. Such countries not only found themselves in balance of payments difficulties but also had to deal with a crisis in their banking system. Private foreign lenders were often insufficiently aware of these kinds of country risk. Also, foreign suppliers of funds frequently found themselves in a tight corner in the emerging markets because of a general lack of transparency with regard to the local economic situation and local economic policy. In addition, in the 1990s greater attention was drawn to the fact that if important hedge funds[3] get into difficulties, this can also generate considerable instability on the financial markets. The sudden high losses of a large American hedge fund (LTCM) which came to light in August and September 1998 (Russian balance of payments crisis) as a result of a dramatic worldwide interest rate hike for international and national risk paper sent out signals to this effect. All these problems and the inherent dangers for the world economy as a whole formed the backdrop against which the Financial Stability Forum was established in April 1999. President Tietmeyer's proposal was made in response to an enquiry which the G7 asked him to conduct in October 1998. His concept was approved at the G7 meeting in February 1999. In addition to the finance ministries, central banks and banking supervisory authorities of the G7 countries, the members of the new informal body include the central banks of four further important international financial centres (as from September 1999) and representatives of those international organisations and bodies

3 "Hedge funds" is the term used to mean financial institutions which consciously take high risks, sometimes on a low equity basis (although the designation "hedge funds" is not entirely apt today since it dates back to an earlier practice when, in contrast to credit risk exposures, market risks were hedged). In various respects, hedge funds are highly leveraged institutions (HLIs). HLIs typically work with high levels of borrowing, are subject to little or no supervision and have only very limited disclosure obligations.

Members of the Financial Stability Forum

Countries or regions
(G7 countries plus some other important financial centres; represented by authorities responsible for financial stability)

- USA
- Japan
- Germany
- France
- United Kingdom
- Italy
- Canada

- Netherlands
- Australia
- Hong Kong
- Singapore

International and European institutions
(Institutions which set the standards crucial to the proper functioning of the markets or monitor their application and the general pattern of development on the financial markets)

- Bank for International Settlements (BIS)
- Basel Committee on Banking Supervision (based at the BIS)
- Committee (of the G10 central banks) on the Global Financial System (based at the BIS)
- International Organization of Securities Commissions (IOSCO)
- International Association of Insurance Supervisors (IAIS)
- International Monetary Fund (IMF)
- International Bank for Reconstruction and Development (World Bank)
- Organisation for Economic Co-operation and Development (OECD)
- European Central Bank (ECB)

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which address matters of financial market stability in depth. The task of the Forum is to expose financial market problems in good time and to identify ways of resolving existing difficulties. The General Manager of the BIS, Andrew Crockett, was appointed *ad personam* Chairman of the FSF. From the start of 2001 he has the support of a worldwide advisory board whose task is, in particular, to acquaint the Forum with the views of the financial industry. The FSF meets twice a year at the level of deputy ministers and deputy central bank governors. Support is provided by a secretariat established at the BIS and ad hoc working groups. The international bodies working together within the Forum also have to deal with the implementation of the recommendations made by this body.

Promoting general observance of recognised standards and codes

The Forum has addressed in some depth the question of how the financial systems of all countries could be made more resistant to crisis by generally observing certain internationally recognised standards and codes. There are currently no fewer than 66 such sets of recommendations. It would hardly be possible for them to be implemented quickly and in full – even by countries in an advanced state of development. As the first step along this path, the Forum defined 12 areas in which each country should endeavour to apply international standards as quickly as possible. These standards and codes[4] can be divided into three categories:

4 Specified in: Deutsche Bundesbank, The role of the International Monetary Fund in a changing global economic environment, Monthly Report, September 2000, page 25.

– First, the main issue is the implementation of internationally agreed rules that are intended to set the financial markets on firm foundations. Primarily, this means ensuring that banks, insurance companies and securities markets are adequately supervised. To this is added the requisite compliance with recognised principles of corporate governance, accounting and auditing. Further rules focus on the ability of the payments systems to withstand a crisis. In addition, certain principles of insolvency law (which have yet to be established in detail) are intended to help to remove widespread legal uncertainties in this area in emerging markets.

– A second category of provisions aims at ensuring the up-to-date publication of a sufficiently broad range of reliable economic data. As the past has shown, lenders have frequently been encouraged to overcommit themselves because of over-optimistic notions about, for example, the amount of monetary reserves.

– The third set of rules is aimed at encouraging the anti-inflationary orientation of monetary and budgetary policy and at reinforcing the conditions under administrative law conducive to establishing financial markets that are as stable as possible. In order to achieve these targets, the internationally agreed codes require a country's policy to be disclosed in line with certain standards. This includes, for example, announcing the intermediate and final monetary policy targets, providing extensive details of the government budget and giving the public precise information about all the rules that apply to the financial markets. The strengths and weaknesses revealed by such criteria are intended to contribute to the swift implementation of necessary reforms.

Implementation with the help of the IMF and the World Bank

The IMF and the World Bank play an important role in ensuring that internationally recognised standards and codes are implemented as quickly as possible. Both institutions play a leading role in this respect because overall strengthening of the financial systems in the member states is one of their key tasks. The coordination of their increased activity in this area is carried out by the joint Financial Sector Liaison Committee, which was set up in 1998. Under the umbrella of this committee, in 1999 the Bretton Woods institutions started to implement Financial Sector Assessment Programs (FSAPs) for selected countries on a voluntary basis as part of a pilot project. For special issues they have the support of experts from other international bodies or foreign national authorities. These programmes serve, within the framework of an internationally consistent procedure, to make the country concerned aware of vulnerabilities of its financial sector and to determine development priorities with the relevant authorities. The IMF uses such analyses, which are in future to be carried out for each country roughly every four to five years, to prepare its Reports on the Observance of Standards and Codes (ROSCs). These reports, which, however, may also be drafted independently of an FSAP, describe national practices in the specific areas and close with an evaluation of the extent to which the procedural method is in line with the corresponding international standards and codes. Financial Sector Stability Assessments are also prepared by the IMF on the basis of an FSAP. These analyses contain a full assessment of the state of the financial system in question as well as information on the associated risks for overall economic development. Regular country monitoring (Article IV Consultations) sets the framework within which findings can be discussed with the relevant authorities. This procedure provides the Executive Directors of the IMF and the World Bank not least with indications of the need for technical assistance. What is more difficult is to fulfil the aim of making sufficient information about the state of each financial system available to private lenders, too. Many emerging markets fear that they could put themselves at a significant financing disadvantage by drawing public attention to ongoing inadequacies. For the time being, account therefore only needs to be taken of the transparency requirement by publishing the Reports on the Observance of Standards and Codes, for which the IMF, however, needs to obtain the approval of the member state concerned. Although the Financial Sector Stability Assessments should, in principle, also be published, the member state under review – if it has given the basic go-ahead for publication – may insist on deleting highly market-sensitive information.

Incentives to encourage implementation

It is important to find sufficient interest among international investors in the course taken. Only in this manner can appropriate expression be given in the credit ratings to information about the extent to which debtor countries are observing the aforementioned recommendations and, as appropriate, about the evaluation of stability in the financial sector. The more this occurs, the greater the incentive for emerging markets to improve the infrastructure of their financial systems as quickly and as extensively as possible. The FSF has played its part in this by making a number of proposals as to how its members can heighten awareness among private lenders and rating agencies of the importance of standards and codes and as to the kinds of special incentives which might be used to encourage the emerging markets to promote the implementation process. An implementation incentive suggested by the Forum could, for example, consist of the industrial countries placing greater emphasis on compliance with standards and codes in their decisions related to the access of foreign financial institutions to the domestic financial market. Such an undertaking would be simplified if – to take account of any possible locational policy concerns on the part of specific industrialised countries – international consistency could be guaranteed.

Crisis prevention by improved government debt and liquidity management

Another important focus of the Forum's activity to date relates to the possible risks associated with excessive short-term external debt. Large short-term foreign currency liabilities on the part of the government and banks were the main reason why the crises of confidence in recent years were able to lead to such dramatic balance of payments crises. The Forum has therefore looked very closely at the problem of the volatility of short-term capital flows. Its published conclusions are wide-ranging. At the core is the recommendation made to the public sector that it should not only aim at minimising the costs of borrowing, but also bear in mind the advantages of longer-term financing in terms of crisis prevention. If short-term government external debt cannot be avoided, the Forum considers that this should be set against appropriate monetary reserves. Moreover, the monetary authorities of debtor countries are advised to bear in mind at least banks' short-term foreign currency debts when setting the targets for the level of monetary reserves. The IMF and the World Bank are currently drafting a series of guidelines for government debt management which will give practical pointers as to how the criterion of risk reduction can best be observed. The Bundesbank has given its firm support to these initiatives, which tackle the roots of the most recent debt crises and are also in line with its long-standing policy of warning the German government against rising and excessive short-term government debt.

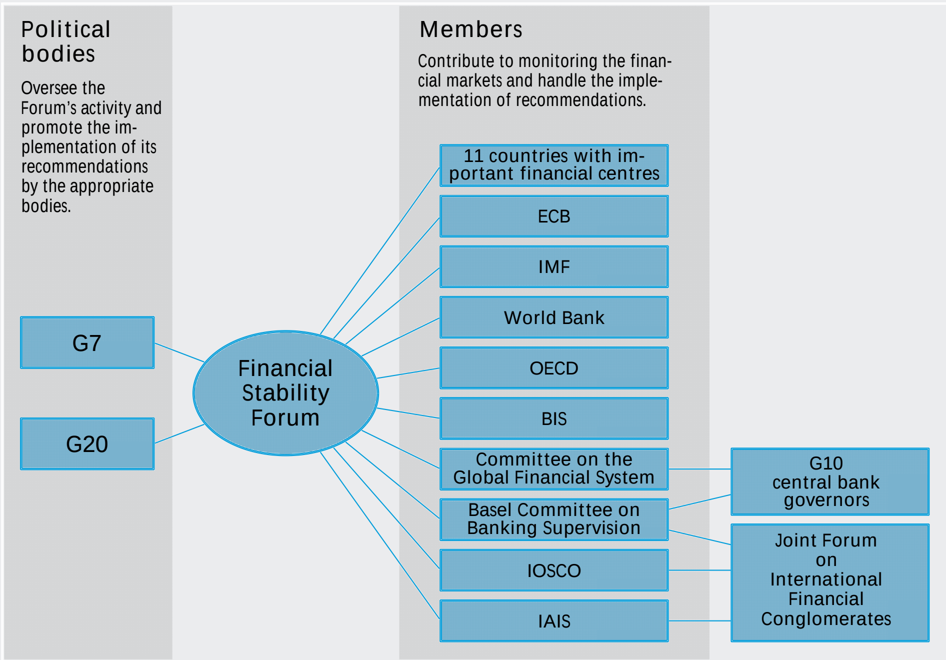
Improved indirect control of HLIs

Given the nature of hedge funds and other highly leveraged institutions (HLIs), the aforementioned problems raised by these institutions do not play a major role in terms of investor protection. However, the likelihood of insolvency of important HLIs entailing difficulties for the banks involved in them cannot be ruled out. The outcome could be disruptions to the global financial system as a whole. The Forum is consequently endeavouring to work towards greater indirect control of HLIs. Measures have been proposed to ensure that HLIs and lending banks tighten up their internal risk management. Should the envisaged indirect measures prove to be insufficient, the Forum will check whether such institutions can be subjected to an additional direct control. No HLIs are set up in Germany because the provisions of the Act on Investment Companies stand in the way of this kind of business policy. Moreover, investment in foreign HLIs may not be offered publicly in Germany as such investment models, due to their limited risk diversification, do not comply with the requirements of the Act on the Sale of Foreign Investment Fund Units.

The FSF's far-reaching monitoring tasks

In summary, the Financial Stability Forum has clearly achieved recognition in the institutional network of international cooperation. Its comparative advantage over other bodies is that the cooperation it instils substantially simplifies and speeds up the coordination between all bodies concerned that is needed to deal with complex issues. As it is an informal body, the FSF's recommendations do not have the authority of those made by an international organisation. However, this drawback is offset by the fact that the Forum tries to implement its proposals for reform – as mentioned above – solely via its members. The decision-making procedures of the corresponding organisations and bodies are thus unaffected. In practice, the Forum therefore also relies on the G7 and the G20 lending political support to its recommendations. Having addressed the problems that it was asked to tackle at the beginning of its activity, the Forum will in future concentrate even more on systematically monitoring all those current developments which could jeopardise the satisfactory functioning of the international monetary and financial system. In so doing, strict confidentiality must be guaran-

Position of the FSF in international cooperation



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teed, so that any imminent or suspected crisis can be addressed openly.

Significance of the G20

Encouraging dialogue between industrial countries and emerging markets in matters concerning the IMF and the World Bank

Similarly to the Financial Stability Forum, the G20 was called into being on the initiative of the G7. The meeting at which this new informal group was launched took place in Berlin in December 1999. The intention to set up the G20 was announced by the G7 finance ministers in June 1999 (in their Report on Strengthening the International Financial Architecture to the economic summit in Cologne) and was reaffirmed in September 1999 by the communiqué of the finance ministers and central bank governors of the G7. The G20's task is to improve the dialogue between industrial countries and emerging markets on important matters related to the international monetary and financial system. In practice, this means encouraging agreement on desirable reforms. The G20 therefore sets out, *inter alia,* to pave the way for decisions in the Bretton Woods institutions, while helping to put their policy into practice by setting an example. It was preceded by similar temporary dialogue and review groups which were set up in 1998 (G22) and 1999 (G33) on similar G7 initiatives. In addition to the G7 countries, the EU and Australia, 11 emerging markets of significance to the world economy are members of the G20. The G20 thus represents two-thirds of the world population, 80 % of world trade (including trade within the EU) and 90 % of the global gross national product. In order to ensure that its activities dovetail as closely as possible

Cooperation levels in informal international bodies

<table>
<tr><th>G7</th><th colspan="2">G10</th><th>G20</th><th>FSF</th></tr>
<tr><td>Finance ministers and central bank governors [1]</td><td>Finance ministers and central bank governors</td><td>Central bank governors</td><td>Finance ministers and central bank governors</td><td>–</td></tr>
<tr><td>Deputy ministers and deputy governors</td><td>Deputy ministers and deputy governors</td><td rowspan="2">Ad hoc meetings of the deputies and four high-ranking standing committees</td><td>Deputy ministers and deputy governors</td><td>Deputy ministers, deputy governors and heads of supervisory authorities [2]</td></tr>
<tr><td>Alternates (excluding central banks)</td><td rowspan="2">Ad hoc groups at different levels</td><td>–</td><td rowspan="2">Ad hoc groups at different levels</td></tr>
<tr><td>Ad hoc groups</td><td>A number of sub-committees and ad hoc groups</td><td>–</td></tr>
</table>

1 The G7 also meets at the level of heads of state or government and, additionally, in the group extended to include Russia (G8). However, for some time this cooperation has covered a range of topics which goes far beyond the competences of the finance ministries and central banks. — **2** The financial centres which participate in addition to the G7 countries are all represented by their central banks (so far the governors have participated).

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with those of the IMF and the World Bank, representatives of the two financial institutions participate in this group as *ex officio* members. Given the focus on the international monetary and financial system, the central banks of the member states are permanent members with equal status, with the EU being represented by the Presidency of the Council and the ECB. The G20 meets once a year at the level of finance ministers and central bank governors.

The NAB group is not a viable alternative

The New Arrangements to Borrow (NAB) between the IMF and a group of 25 industrial countries and emerging markets which came into force in 1998 – concluded according to the pattern set by the General Arrangements to Borrow (GAB) – do not constitute a group of countries capable of pursuing the objectives of the G20 in a similar manner. In addition to the G10 countries working together on the basis of the GAB, the NAB include numerous other industrial countries but, in all, only seven emerging markets, some of which are in any case today no longer considered financially strong (a requirement of the NAB). The NAB participants (as in the G10 and G20, represented in each case by the government and the central bank) meet regularly to discuss current issues in the margins of the annual meeting of the IMF and the World Bank, but this group of countries cannot claim to carry out a representative dialogue between industrial countries and emerging markets.

The G20 has clearer points of contact with the IMF's International Monetary and Financial Committee (IMFC). The role of the former

Members of the G20 compared with the NAB and the IMFC

Order based on a combination of political, regional and economic aspects

G20	IMF's New Arrangements to Borrow (NAB) [1]	IMF's International Monetary and Financial Committee (IMFC) [2]
Industrial countries		
USA	USA	USA [3]
Japan	Japan	Japan [3]
Germany	Germany	Germany [3]
France	France	France [3]
United Kingdom	United Kingdom	United Kingdom [3]
Italy	Italy	Italy [4]
Canada	Canada	Canada [4]
EU (incl. ECB)		
Australia	Australia	Australia [4]
	Netherlands	Netherlands [4]
	Switzerland	Switzerland [4]
	Belgium	Belgium [4]
	Sweden	
	Spain	
	Austria	
	Denmark	
	Norway	
	Finland	(Finland)
	Luxembourg	
Developing and transitional countries		
Saudi Arabia	Saudi Arabia	Saudi Arabia [5]
		(Iran)
		(Egypt)
	Kuwait	
Brazil		(Brazil)
Mexico		
Argentina		(Argentina)
		(Venezuela)
Russia		Russia [5]
China		China [5]
India		India [4]
South Korea	South Korea	
	Hong Kong	
	Thailand	
Indonesia		(Indonesia)
	Singapore	
	Malaysia	
Turkey		
South Africa		(South Africa)
		(Gabon)
Participating international bodies		
IMF	IMF	IMF
World Bank		World Bank
IMFC Chairman		
JDC Chairman [6]		JDC Chairman [6]
		EU Presidency
		EU Commission
		ECB
		BIS
		FSF
		OECD
		WTO
		UNCTAD [7]
		ECOSOC [8]
		ILO [9]

1 Of the participants listed below, the G7 countries together with The Netherlands, Switzerland, Belgium and Sweden form a sub-group which is prepared to grant the IMF refinancing aid in accordance with the General Arrangements to Borrow (GAB). The GAB are also the basis for broader cooperation in this group of countries within the framework of the G10 (Switzerland has since become the eleventh participant in the GAB). Saudi Arabia is an associate member of the GAB. — **2** The composition is based on the representation of the IMF member countries on the Fund's Executive Board, with a distinction to be made between appointed and elected Executive Directors. Of the elected Executive Directors, there are some who represent their own country rather than a constituency. Countries from constituencies whose representative on the Executive Board normally changes are shown in brackets (position as at the start of 2001). — **3** Member appointed in accordance with the Fund Agreement. — **4** As the economically most significant representative of a constituency, traditionally continuously re-elected. — **5** Owing to the country's major economic significance, continuously re-elected. — **6** Chairman of the Joint Development Committee (JDC) of the IMF and the World Bank. — **7** United Nations Conference on Trade and Development. — **8** Economic and Social Commission (of the United Nations). — **9** International Labour Organisation.

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Points of contact between the G20 and the IMFC

Interim Committee of the IMF was upgraded on a recommendation by the G7 with effect from spring 2000 by its being transformed into a permanent body which was then named the IMFC. As a committee of the Board of Governors, the IMFC has an important control and mediation function in respect of the decision-making bodies of the IMF (Board of Governors and Executive Board). To this end, the Committee meets twice a year at the level of the finance ministers (with the participation of the central banks). Its country composition parallels the current representation of all IMF members in the Executive Board. This means that those countries that do not have their own Executive Director in the IMF are represented within the framework of country groups (constituencies), partly by continuously re-elected spokesman countries (mainly industrial countries) but mainly by countries which take turns to act as spokesman. As a forum for the dialogue between industrial countries and emerging markets, the G20 therefore has certain advantages over the IMFC. Owing to its focus on the two Bretton Woods institutions, it is also more broadly oriented. However, because of its formal legitimation and the full representation of IMF members, the IMFC's control and mediatory function remains secure.

G20 provides political support for globalisation

At the first G20 meeting in Berlin in December 1999 the participating countries undertook to take an exemplary lead in the implementation embarked upon by the IMF and the World Bank of the Financial Sector Assessment Programs (FSAPs) and in the drafting of Reports on the Observance of Standards and Codes (ROSCs). The second G20 meeting in Montreal in October 2000 was devoted to the opportunities and challenges afforded by globalisation. The common denominator in this discussion was the conviction that economic integration can continue to be a major driving force for economic and social progress in all countries. The communiqué issued by the group lists a number of features which should be taken into account with regard to the globalisation process so that the problems arising from increasing competition can be mastered. The communiqué cites the support of all ongoing initiatives which aim to gradually reduce the financial vulnerability of emerging markets as being of prime importance. In addition, the statement stresses the urgent need for a number of development policy measures.

Recent developments at the European level

Enhanced coordination within the Eurogroup

Informal group based on a Resolution of the European Council

Even before it had been decided which countries would participate in European Monetary Union, the European Council had empowered the euro area economics and finance ministers to meet informally as a group of euro area countries to discuss issues related to their particular responsibility for the single currency. This authorisation is part of the Resolution of the European Council of December 1997 on economic policy coordination in stage three of Economic and Monetary Union (EMU) and on Articles 111 and 113 (ex Articles 109 and 109b) of the Treaty establishing the European Community (EC Treaty).[5] The Resolution of the European Council affirms that the EU Council in the composition of the economics and finance ministers (Ecofin Council) shall function as foreseen in the EC Treaty as the central economic policy coordination body of the EU countries because this is the only way that cohesion of the EU as a whole can be ensured. This concerns, in particular, decision-making powers. However, it goes without saying that matters related to the functioning of Monetary Union require particular attention on the part of those countries which have adopted the single currency. With the planned gradual expansion of the EU from the current 15 to up to 28 member states, the existing restriction of Monetary Union to a part of the EU area only is further accentuated and this lack of congruence is likely to continue for a relatively lengthy period of time because of the broad, fundamental process of convergence which is required for accession to Monetary Union. The empowerment of the European Council to strengthen cooperation among the euro area economics and finance ministers therefore took account of a development the increasing significance of which could not necessarily be foreseen when the Maastricht Treaty was formulated. The Eurogroup was, in fact, formed at the start of Monetary Union. The Resolution of the European Council provides that the European Commission must be involved in all meetings of this kind. In addition, the Eurogroup has consistently made use of the opportunity referred to in the Resolution of including the ECB in its meetings. The group is led, as a matter of principle, by the six-monthly rotating presidency of the Ecofin Council.[6] If the presidency of the Ecofin Council falls to a country which is not participating in Monetary Union (for example, Sweden in the first half of 2001), the presidency of the Eurogroup is assumed by the subsequent euro area country in the Ecofin Council (e.g. Belgium thus assumes the presidency of the Eurogroup for the whole of 2001). The group meets, in principle, once a month, on the day before the monthly meeting of the Ecofin Council. When France assumed the presidency of the Eurogroup for the first time in the second half of 2000, the activity of this body was intensified. So far, the Eurogroup has taken an in-depth look at economic and budgetary development in the euro area countries and their problems in the field of structural policy. Not least, it has addressed the causes of the period of marked weakness of the euro.

The Eurogroup is no substitute for necessary political integration

Market participants as well as official representatives of the euro area have frequently attributed the weakness of the euro, in part, to the fact that the public fails to perceive the euro area as an autonomous political entity. This kind of criticism at least raises an important issue. From the outset, as preparations for Monetary Union were being made, the Bundesbank had made a point of stressing that a monetary union needs a political foundation if it is to be able to function properly over the long term. This implies the need for efficient Community bodies as well as for a coherent way of tackling important policy

5 The Resolution is featured on pages 28–29. The Eurogroup is addressed in item 6.
6 The rotation of the EU presidency was established by a Council Decision of January 1995.

areas. Otherwise it would difficult to imagine how a basis of confidence for the euro, which would remain unshaken in times of difficulty, could be established on the financial markets. Consequently, the Eurogroup of economics and finance ministers cannot be a substitute for the necessary broad political basis of the single currency but can make only a relatively modest contribution in this respect. Vigilance is even called for so that greater cooperation between the euro area countries than in the Ecofin Council does not foster ideas that are also focused on monetary policy and would, in the long run, tend to be detrimental to the internal and external stability of the euro.

Limited progress towards political union

The necessary strengthening of political integration must take account of the special European situation, which is characterised by a vast cultural, historical, economic and political multiplicity. In view of this rich heritage, the integration process is likely to boil down finally to a political structure *sui generis*. The decisions taken at the European intergovernmental conference in Nice in December 2000 will further strengthen the institutional infrastructure in Europe, even if the achievements lag considerably behind expectations and legitimate aspirations. In addition, the Union is endeavouring, on the basis of the treaties of Maastricht and Amsterdam, to develop a common foreign and security policy (CFSP), to strengthen cooperation in legal and internal policy and, in part, to develop it into a common policy. It is, however, easy to conceive of further areas that might appropriately be covered by a broader common policy, e.g. environmental protection. Overall, there is therefore still a lot of catching up to be done in terms of measures which could contribute to founding a pan-European identity while giving the euro more political backing.

"Peer pressure" to speed up economic policy reforms

Nonetheless, there is only a partial need for further harmonisation in the policy areas that are directly relevant to the functioning of European Monetary Union. By means of the Stability and Growth Pact, which clarifies the rulings of the EC Treaty and establishes the conditions of their concrete application, key arrangements were made to preclude the risk of the anti-inflationary monetary policy being jeopardised by lax budgetary policies. In addition, economic policy which is committed to free market principles and based mainly on free price formation, competition, the international division of labour and the unrestricted movement of capital constitutes the best conceivable foundation for a stability-oriented monetary policy. These necessary foundations also include further progress towards a regulatory tax framework which guarantees fair competition across the whole of Europe and thus safeguards the functioning of the single market. However, it is neither necessary nor desirable to aim for a common financial policy which goes beyond the requirements of the Stability and Growth Pact. Similarly in wage and structural policy, neither central decisions nor cross-border coordination is necessary to safeguard Monetary Union over the long term. Rather, all three areas referred to need to conduct a policy of reform that is geared to the country-specific obstacles to growth and employment. What is needed is consistent budgetary consolidation, ongoing decentralisation of wage agree-

Resolution of the European Council of 13 December 1997 on economic policy coordination in stage 3 of EMU and on Treaty Articles 109 and 109b of the EC Treaty *

I. Coordination of economic policies in stage 3 of economic and monetary union (EMU)

1. EMU will link the economies of the euro-area Member States more closely together. They will share a single monetary policy and a single exchange rate. Cyclical developments are likely to converge further. Economic policies, and wage determination, however, remain a national responsibility, subject to the provisions of Article 104c of the Treaty and the Stability and Growth Pact. To the extent that national economic developments have an impact on inflation prospects in the euro-area, they will influence monetary conditions in that area. It is for this basic reason that the move to a single currency will require closer Community surveillance and coordination of economic policies among euro-area Member States.

2. Economic and monetary interdependence with non-participating Member States will also be strong; they all participate in the single market. The need to ensure further convergence and a smooth functioning of the single market therefore requires all Member States to be included in the coordination of economic policies. Moreover, interdependence will be especially strong if non euro-area Member States participate in the new exchange rate mechanism, as countries with a derogation are expected to.

3. Enhanced economic policy coordination should give full attention to national economic developments and policies which have the potential to influence monetary and financial conditions throughout the euro area or the smooth functioning of the internal market. This includes:

   – close monitoring of macroeconomic developments in Member States to ensure sustained convergence, and of exchange-rate developments of the euro,

   – surveillance of budgetary positions and policies in accordance with the Treaty and the Stability and Growth Pact,

   – monitoring of Member States' structural policies in labour, product and services markets, as well as of cost and price trends, particularly insofar as they affect the chances of achieving sustained non-inflationary growth and job creation, and

   – the fostering of tax reform to raise efficiency and the discouragement of harmful tax competition.

   Enhanced economic policy coordination must adhere to the Treaty principle of subsidiarity, respect the prerogatives of national governments in determining their structural and budgetary policies subject to the provisions of the Treaty and the Stability and Growth Pact, respect the independence of the European System of Central Banks (ESCB) in pursuing its primary objective of price stability and the role of the Ecofin Council as the central decision-making body for economic coordination, and respect national traditions and the competences and responsibilities of the social partners in the wage formation process.

4. To ensure the smooth functioning of EMU, the Council, the Commission and the Member States are called upon to apply the Treaty instruments for economic policy coordination fully and effectively.

   To this end, the broad economic policy guidelines adopted in accordance with Article 103(2) of the Treaty should be developed into an effective instrument for ensuring sustained convergence of Member States. They should provide more concrete and country-specific guidelines and focus more on measures to improve Member States' growth potential, thus increasing employment. Therefore, more attention should henceforth be paid in them to improving competitiveness, labour-, product- and services-market efficiency, education and training, and to making taxation and social protection systems more employment-friendly.

   Enhanced coordination should be aimed at securing consistency of national economic policies and their implementation with the broad economic policy guidelines and the proper functioning of EMU. Economic policies and development in each Member State and in the Community should be monitored in the framework of multilateral surveillance according to Article 103(3) of the Treaty. Particular attention should be paid to giving early warning, not only of threatening budgetary situations in accordance with the Stability and Growth Pact, but also of other developments which, if allowed to persist, might threaten stability, competitiveness and future job creation. To this end, the Council is expected to be more ready to make the necessary recommendations in accordance with Article 103(4) of the Treaty to a Member State whenever its economic policies are not consistent with the broad economic policy guidelines. For its part, the Member State concerned should commit itself to take timely and efficient measures which it deems necessary to respond to the Council's recommendations. Moreover, the Member States should commit themselves to a comprehensive and speedy exchange of information on economic developments and policy intentions with a cross-border impact.

5. Monitoring of the economic situation and policy discussions should become a regular item on the agenda of informal Ecofin sessions. In order to stimulate an open and frank debate, the Ecofin Council should from time to time meet in restricted sessions (minister plus one), particularly when conducting multilateral surveillance.

6. Under the terms of the Treaty, the Ecofin Council [1] is the centre for the coordination of the Member States' economic policies and is empowered to act in the relevant areas. In particular, the Ecofin Council is the only body empowered to formulate and adopt the broad economic policy guidelines which constitute the main instrument of economic coordination.

***** Quoted (excluding recitals) from: European Commission, Economic and Monetary Union, Compendium of Community Law, June 1999. —

1 Declaration No 3 to the Treaty on European Union affirms that for the purpose of applying the provisions set out in Title VI on economic and

Deutsche Bundesbank

The defining position of the Ecofin Council at the centre of the economic coordination and decision-making process affirms the unity and cohesion of the Community.

The Ministers of the States participating in the euro-area may meet informally among themselves to discuss issues connected with their shared specific responsibilities for the single currency. The Commission, and the European Central Bank (ECB) when appropriate, will be invited to take part in the meetings.

Whenever matters of common interest are concerned they will be discussed by Ministers of all Member States.

Decisions will in all cases be taken by the Ecofin Council in accordance with the procedures determined by the Treaty.

II. Implementing the Treaty provisions on the exchange-rate policy, external position and representation of the Community (Article 109 of the Treaty)

7. The European Council recognises the responsibility which will fall to the Community with the introduction of the euro, one of the major currencies in the world monetary system. The contribution of the Community through the ESCB, in strict accordance with the competences and procedures established by the Treaty, will be to provide a centre of price stability. For its part, the European Council is resolved to play its full part in helping to lay the foundations for a prosperous and efficient economy in the Community, in accordance with the principle of an open economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 3a of the Treaty. The European Council is convinced that this will provide the bases for a currency which is strong and respected.

8. The Council should monitor the development of the exchange rate of the euro in the light of a wide range of economic data. The Commission should provide analyses to the Council, and the Economic and Financial Committee should prepare the Council's reviews. It is important to make full use of the Treaty provisions to ensure an exchange of information and views between the Council and the ECB on the exchange rate of the euro. While in general exchange rates should be seen as the outcome of all other economic policies, the Council may, in exceptional circumstances, for example in the case of a clear misalignment, formulate general orientations for exchange-rate policy in relation to non-EC currencies in accordance with Article 109(2) of the Treaty. These general orientations should always respect the independence of the ESCB and be consistent with the primary objective of the ESCB to maintain price stability.

9. The Council should decide on the position of the Community at international level as regards issues of particular relevance to economic and monetary union, in accordance with Article 109(4) of the Treaty. These positions will be relevant both to bilateral relations between the European Union and individual third countries and to proceedings in international organizations or informal international groupings. The scope of this provision is necessarily limited as only euro-area Member States vote under Article 109.

10. The Council and the European Central Bank will carry out their tasks in representing the Community at international level in an efficient manner and in compliance with the allocation of powers laid down in the Treaty. On elements of economic policy other than monetary and exchange-rate policy, the Member States should continue to present their policies outside the Community framework, while taking full account of the Community interest. The Commission will be involved in external representation to the extent required to enable it to perform the role assigned to it by the Treaty.

    Representation in international organizations should take account of those organizations' rules. With particular regard to the Community's relations with the International Monetary Fund (IMF), they should be predicated upon the provision in that Fund's Articles of Agreement that only countries can be members of that institution. The Member States, in their capacities as members of the IMF, should help to establish pragmatic arrangements which would facilitate the conduct of IMF surveillance and the presentation of Community positions, including the views of the ESCB, in IMF fora.

III. Dialogue between the Council and the ECB

11. In the light of the allocation of responsibilities laid down in the Treaty, the harmonious economic development of the Community in stage 3 of EMU will call for continuous and fruitful dialogue between the Council and the ECB, involving the Commission and respecting all aspects of the independence of the ESCB.

12. The Council should therefore play its full part in exploiting the channels of communication provided by the Treaty. The President of the Council, using his position under Article 109b of the Treaty, should report to the Governing Council of the ECB on the Council's assessment of the economic situation of the Union and on economic policies of the Member States and could discuss with the ECB the views of the Council on exchange-rate developments and prospects. The Treaty provides in turn for the ECB President to attend Council meetings whenever the Council is discussing matters relating to the objectives and tasks of the ESCB, for instance when the broad economic policy guidelines are being developed. Importance also attaches to the annual reports which the ECB will make to the European Parliament, the Council and the Commission, as well as to the European Council.

    The Economic and Financial Committee, which will bring together senior officials from the national central banks and the ECB as well as from finance ministries, will provide the framework within which the dialogue can be prepared and continued at the level of senior officials.

monetary policy of the Treaty establishing the European Community, the usual practice, according to which the Council meets in the composition of Economic and Finance Ministers, shall be continued, without prejudice in Article 109j(2) to (4) and Article 109k(2) of the Treaty.

ments and further flexibilisation of the labour and product markets. By putting "peer pressure" on its members, the Eurogroup can serve Monetary Union well. At its meeting in Nice in December 2000, the European Council rightly established structural policy challenges as the focus of the Eurogroup's tasks, as can be seen from the published presidency conclusions. It is in keeping with this role of the Eurogroup that the right conferred on the President of the Ecofin Council pursuant to the EC Treaty to take part in meetings of the Governing Council of the ECB as an observer is taken up by the President of the Eurogroup as a result of an informal agreement in the Ecofin Council, if – as in the first half of 2001 – the country heading the Ecofin Council is not participating in Monetary Union.

The Eurogroup has no powers in the field of exchange market intervention

The scepticism confronting the Eurogroup has to do with fears that this body, in contrast to the important tasks outlined above, could function mainly as a political counterweight to the Governing Council of the ECB, i. e. as a sort of control mechanism. It was therefore very helpful that at its meeting in December 1999 the European Council, by accepting a report by the Ecofin Council, stressed that the ECB will participate in cooperation among the euro area countries in the field of economic policy simply in the context of a dialogue, without going so far as to bring monetary policy in line *ex ante* with other policy areas. In order to defuse once and for all the ideas concerning the Governing Council of the ECB which are not in keeping with the EC Treaty, it is also necessary to make a clear distinction between the overlapping responsibilities of the governments of the member states and of the Governing Council of the ECB in the field of exchange rate policy. Pursuant to Article 111 of the EC Treaty (ex Article 109), the Ecofin Council may, acting unanimously (but pursuant to Article 122, with the "pre-ins" not entitled to vote) on a recommendation from the ECB or from the Commission, and after consulting the ECB, adopt, adjust or abandon formal exchange rate agreements for the euro in relation to non-Community currencies. In addition, the Council may, acting by a qualified majority, by the otherwise same procedure, formulate general orientations for exchange rate policy which, however, must not jeopardise the primary objective of European Central Bank policy to maintain price stability and which would be binding on the Governing Council of the ECB only to the extent that they are without prejudice in practice to its stability-oriented monetary policy. Moreover, such guidelines may be formulated in exceptional circumstances only, for example in the case of significant exchange rate misalignment.[7] The Ecofin Council's powers in the field of exchange rate policy involve the Council keeping an eye on the situation on the foreign exchange markets. To this end the Resolution of the European Council of December 1997 also emphasises the importance of an exchange of views and information between the bodies responsible for economic policy and the ECB. As mentioned above, in practice the movements on the foreign exchange market are evaluated mainly in the Eurogroup, whose spokesperson – who in the current 15 EU member states usually also heads the Ecofin

7 See item 8 of the Resolution of the European Council of December 1997 on page 29.

Council – represents the stance of the euro area ministers on exchange rate issues in respect of other international bodies and the general public. Conversely, the decision on possible interventions on the foreign exchange market is the sole responsibility of the Governing Council of the ECB, as political measures aimed at protecting certain exchange rates could conflict with the objective of maintaining price stability. It is true that the direct impact of foreign exchange market interventions on monetary conditions is offset by the ECB. The expansive or contractive effects of foreign exchange market operations are countered by opposite liquidity policy measures. However, the principle of sterilising foreign exchange market interventions in no way rules out, in the case of a rising euro, the possibility of political exchange rate objectives causing considerable difficulties for monetary policy. Owing to the direct interdependence of prices on external and internal markets, an exchange rate which is maintained at an artificially low level can increase the inflationary pressure as a result of excessive import prices. Moreover, if the interventions were politicised, the main danger would be that attempts to stem an increase in the exchange rate by buying currency could set up strong political pressure for a relaxation of monetary policy. At the end of the day, such an impact would feed doubts as to whether European monetary policy, as previously the Bundesbank's policy, will remain committed to purchasing power stability whatever the circumstances. The Eurogroup should therefore take care not to give the public the impression of wanting to be involved in defining intervention policy. Its role can only be to support possible foreign exchange market interventions by means of corresponding economic and financial policy measures. What must be considered here are the periods of weakness of the euro, which could indicate a need for economic policy to be adjusted. Moreover, it should be stressed that should there be critical exchange rate developments, in view of the close integration of the euro area in the global economy, foreign exchange market interventions can never significantly offset the flow of currency caused by exchange rate volatility. Interventions can only be a signal that the Governing Council of the ECB views certain exchange rate developments as problematic. Before the ECB gives such a sign, it must be thoroughly convinced that the economic and monetary policy framework conditions allow exchange rate misalignment to be reliably diagnosed. If there were any doubts in this respect, intervention could be ineffective and, even more, it could increase the pressure on the foreign exchange markets.

Role of the IRC in European cooperation

IRC defines common positions and basic orientations

The task of the International Relations Committee (IRC), which was set up within the framework of the ESCB in the second half of 1998 (i.e. before the start of Monetary Union), is to prepare the required common positions with regard to all international matters which fall within the field of competence of the Eurosystem and the ESCB (including monetary policy issues related to the eastward enlargement of the EU). However, the Committee's mandate approved by the Governing Council of the ECB goes still further. The Committee is, in particular, to monitor the functioning of the international monetary system and the international financial markets and to adopt a position on the related problems discussed at an international level and on the possibilities for improvement. The Committee meets at the level of members of the decision-making bodies of the ECB and the national central banks. The meetings take place, in principle, once a month in the composition of the Eurosystem. If matters are discussed which are related to the tasks of the General Council of the ECB (such as the European exchange rate regime), the representatives of the "pre-ins" also participate. They also take part in IRC meetings if matters of international importance are discussed which go beyond the competence of the Eurosystem and the ESCB. On essential matters beyond the sphere of responsibility of the Eurosystem or the ESCB, the IRC simply indicates basic orientations ("common understandings", "common views" or "common terms of reference") to the decision-making bodies (Governing Council and General Council of the ECB) rather than making proposals for a common position. They are to act as guidelines for the national and international activities of all central banks in the ESCB.

Stability of the international monetary and financial system is in the best interests of the ESCB

Coordination within the ESCB in the case of important international matters which go beyond its statutory competence is, in the final analysis, a result of the obligation of the EU central banks to maintain price stability and of the mandate of the ESCB to support the competent authorities in the field of banking supervision and the stability of the financial system. Each central bank which pursues a stability-oriented policy must be interested in shaping the various facets of the functioning of the international monetary and financial system in such as way as to enable a sound economic and monetary policy to be implemented in as many countries as possible and a high degree of stability of the banking and financial systems to be ensured. Otherwise its own stability policy can be jeopardised, either by imported inflation or by difficulties in its own banking system caused by foreign borrowers. The Bundesbank has been very involved from the outset in all matters related to the monetary and financial system. The ESCB continues to pursue this line. It is therefore, for example, a good thing that joint discussions in the IRC on the future role of international official financial support have produced a consensus to jointly aim at achieving a turn-around in crisis management leading to far greater involvement on the part of private creditors. This is the key to ensuring a better functioning of the international financial markets over the long term.

Basic orientations of the IRC leave a lot of room for manoeuvre

The positions agreed within the IRC (and ultimately in the decision-making bodies of the ECB) on those international matters which fall within the competence of the Eurosystem or the ESCB are basically represented by the ECB in other European bodies (Economic and Financial Committee, Eurogroup and Ecofin Council) and at the international level. By contrast, common basic orientations with regard to aspects which lie outside Community competence only provide the ECB and the individual national central banks with a basis on which they can continue to work independently towards accredited objectives. The national central banks thus also have, in particular, a guideline established from a monetary policy perspective for advising their own governments. If the central banks achieve a consensus over specific basic orientations in such matters, no attempt is made to agree on detailed provisions. The exchange of views in the IRC rather takes account of the fact that all central banks (including the ECB) can, in dialogue with the national governments and in international bodies, make the contributions to discussion expected of them with the requisite flexibility.