CREATING THE ECONOMIC AND MONETARY UNION IN EUROPE, A REQUISITE FOR MAINTAINING THE EFFICIENCY AND STABILITY OF THE INDIVIDUAL AND THE GROUP FINANCIAL SYSTEM

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Abstract:
The Eurosystem in an active factor in consolidating the measures which contribute to the financial stability of both the euro area and the European Union, generally, and it has become more and more necessary due to the ever stronger tendency towards integrating and developing the financial markets in Europe. In the field of financial crisis management, through the BCE, the Eurosytem performs annual macro-prudential and structural appraisals of the banking system in the EU and promotes closing voluntary cooperation agreements between the authorities. In order to consolidate financial stability, a constant improvement of the monetary policies is necessary to respond to the challenges arising from the complexity of the EU institutional framework.

Key words: the European Union, the Eurosystem, monetary policy, financial stability.
JEL classification: E52, E58, G21

I. Introduction[1]

I.1. European Integration

The process of creating the economic and monetary union in Europe was anticipated by the setting up of the Coal and Steel European Community (CSEC) in 1952, which was made of six European states: Belgium, Germany, France, Italy, Luxemburg and the Netherlands.

În 1958, the same six states founded the European Economic Community (ECC) and the European Community of Atomic Energy (ECAE). In time, after consolidating the interstate relationships, there appeared the European Community

[1] The European Central Bank, the Eurosystem, the European System of Central Banks (April, 2009);

(EC) and in 1993, after adopting the Maastricht treaty, the European Union was born.

Between 1973-2007, the number of the member states of the European Union increased to 27, after the following countries joined in: Denmark, Ireland, the UK (1973), Greece (1981), Portugal and Spain (1986), Austria, Finland and Sweden (1995), the Check Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia, Slovakia (2004), Bulgaria and Romania (2007).

I.2. The terms for joining the European Union (EU)

The countries that wished to join the EU had to meet some requirements called the "Copenhagen criteria", which stated that the future member states:

- should have stable institutions to guarantee democracy, the lawful state, the human rights as well as respect and protect the minorities;
- should have a functional market economy and the capacity to face competitive pressures.

I.3. The stages towards creating the Economic and Monetary Union

The following stages led to the formation of the European and Monetary Union:

1. the first stage spanned 3 years, between 1990-1993, and was characterized by the definition of the unique European market after knocking down the barriers against the free circulation of the people, goods, capital and services in Europe;

2. the second stage lasted four years, between 1994-1998, and started by setting up the European Monetary Institute and preparing technically to adopt the unique currency, to avoid excessive deficits and to increase the convergence of the economic and monetary policies of the member states (with a view to stabilizing the prices and ensuring the soundness of public finances);

3. the third stage started on January 1st 1999 by irrevocably fixing the exchange rates, transferring the competencies in the field of monetary policies and introducing the euro as a unique currency.

By joining the EU, the member states take on the responsibility of adopting the euro in a definite number of years necessary to meet the convergence criteria.

I.4. The convergence criteria for the unique currency

The Maastricht treaty stipulates that the states wanting to adopt the unique currency must meet certain criteria to demonstrate a high level of "durable convergence", such as:

- a high level of price stability;
- solid public finances;
- a stable exchange rate;
- a low and stable long-term interest rate;
- the independence of the state central bank;

These criteria can only be met by those states that promote economic policies oriented towards stability and present a long history of price stability.

II. The Eurosystem and the European System of the National Central Banks[1]

The Eurosystem is represented by the Central European Bank and the National Central Banks of the member states that have adopted the euro (16 states at present).

The Central Banks European System of the (CBES) is made of the Central European Bank and the national central banks of all the member states of the EU.

The Central National Banks of the member states that have not adopted the unique currency have their own monetary policy competencies, according to their national legislation. (The Romanian National Bank is part of the CBES.)

II.1. The responsibilities of the Eurosystem

The Eurosystem has four main responsibilities:

1. to enforce the monetary policy adopted by the Central European Bank (for instance, the decisions about the rates of the representative interests, the decisions regarding the monetary objectives and the cash flow)
2. to perform currency operations
3. to administer the official resources of the states belonging to the euro area
4. to promote the good functioning of the payment systems

(Other responsibilities: financial supervision, elaborating monetary and financial statistics, counseling legislators in its competency area, issuing euro notes.)

Special attention should be paid to the fact that the Eurosytem is not allowed to give loans to communitarian institutions or entities in the national public sector, which enhances its independence and protects it from any type of influence from the public authorities.

Following the Greek financial crisis (2010), there appeared the idea of setting up a new European organism, a European Monetary Fund, meant to give support to the member states of the Eurosystem that are in need of immediate help (at present the Eurosystem is not allowed to back them up).

II.2. The Objectives of the Eurosystem

The main objective of the Eurosystem is to maintain price stability. The other objectives (social and economic progress, high employability of the work force, a durable and well-balanced development) can only be attained by maintaining price stability.

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[1] The European Central Bank, the Eurosystem, the European System of Central Banks (April, 2009);

Inflation and deflation are important economic phenomena that can have a negative influence on economy.

Inflation is defined as a general long-term increase in prices and services which leads to money devaluation and thus to a low purchasing power.

Deflation is defined as a long-term price decrease.

Price stability is characteristic for a period affected by neither inflation nor deflation.

It is important to distinguish between the price variations for individual commodities and services and the general price level. Frequent alterations of the individual prices are quite normal in a market economy, even during general price stability. Changing the terms for the demand and supply of the individual goods and services leads to price variations.

Inflation is usually measured by the "consumer price indicator". The consumer purchase patterns are analysed to identify the commodities and services usually purchased by the consumers and considered representative for the average consumption in a certain economy.

Listing these items under "most purchased" and pondering them according to their importance in the consumer budget leads to what is called "the consumer bare necessities". It must be mentioned that price evolution approached in this way represents only "the average" consumer. To put it differently, inflation measured by means of the indicator is only an approximation of the average economic situation which does not equal the variations of the general price level each consumer faces.

II.2.1. The main advantages of price stability

1. Price stability enables the population and companies to identify some commodities price variations and compare them, thus being able to make their own decisions regarding consumption and investments.

2. Price stability allows creditors to give up the "inflation risk premium" to compensate for the inflation risk associated with long-term nominal assets. Taking advantage of the premiums decrease, the debtors can use their resources more efficiently to invest in creating more jobs and developing general economic prosperity.

3. Price stability motivates individuals and companies not to use production resources to protect themselves against inflation or deflation (for instance, adjusting nominal income to price evolution), thus contributing to economic development.

4. Price stability prevents major economic, social and political problems regarding random wealth and income distribution observed during inflation and deflation.

For instance, when inflation is high, people putting money into banks are confronted with a decrease of the real value of their savings, while loan takers have

to reimburse a smaller real amount. There appears thus a relative transfer of goods from bank savers to loan takers. Deflation is characterized by the opposite transfer.

5. Abrupt reevaluation of the assets following an unpredictable variation of inflation can compromise the solidity of a bank balance sheet.

For instance, an unpredictable rise in the inflation rate will lead to the decrease of the assets' real value, and the bank can face solvability problems. If price stability is maintained through the monetary policy, inflation or deflation shocks aiming at the nominal assets real value are avoided, financial stability being thus consolidated.

By maintaining price stability, central banks contribute to reaching the general economic targets, such as: a higher life standard, a more stable expansion of economic activity and higher employability of the labour force.

II. 3. The instruments of monetary policy helping the Eurosystem to reach its targets[1]

To reach its targets, the Eurosystem has a set of monetary policy tools, such as:

a. operations on the monetary market
b. permanent facilities
c. minimal obligatory resources

a. Operations on the monetary market

The operations on the monetary market play an important part in the monetary policy of the Eurosystem and their aim is to guide the interest rates, to set the cash terms on the market and the directions of the monetary policy. There are five types of instruments used for operations on the monetary market: reversible transactions (applicable through repo contracts and collateral loans), simple transactions, issuing debt certificates, currency swap operations and attracting term deposits. The operations on the monetary market are initiated by CBE and unfolded by the national banks of the Eurosystem and they can be achieved by standard auctions, fast auctions or bilateral procedures.

The operations on the monetary market of the Eurosystem fall under the following categories, according to their objectives, their timing and procedures, as follows:

- main refinancing operations, which are reversible and periodical, with a view to getting liquidity, performed on a weekly basis and generally reimbursed in a week;
- liquidity operations and long-term refinancing, which are reversible, with a view to getting cash, performed on a monthly basis and generally reimbursed in three months;

[1] The implementation of monetary policy in the euro area – General documentation on Eurosystem monetary policy instruments and procedures (November, 2008) ;

- fine tuning operations, performed on the spot, with a view to getting cash on the market and orienting the interest rates, meant to minimize the effects on the interest rates by the unanticipated fluctuations of the liquidity on the market. These operations are generally performed by the national central banks by fast auctions and bilateral procedures;
- structural operations, which are performed by issuing debt certificates, reversible and simple transactions. These operations are performed when BCE aims at adjusting the structural position of the Eurosystem according to the financial sector and are solved by bilateral procedures

b. Permanent facilities

The permanent facilities are administered in a de-centralised way by the national central banks. The aim of the permanent facilities is to provide and absorb overnight liquidity, to set the general direction of the monetary policy and to limit the fluctuation of the overnight interest rates on the market. They are:

- marginal crediting, used to get overnight liquidity from the national central banks in exchange for eligible assets;
- facilitating deposits, used to place overnight deposits in the national central banks.

c. Minimal obligatory stocks

The minimal obligatory stocks of the Eurosystem (MOS) are applicable to the crediting institutions in the euro area and aim at stabilizing the interest rates on the monetary market and creating a structural cash deficit. The minimal obligatory stocks are determined for each institution according to the elements present in their balance sheet. They are remunerated respecting the interest rate corresponding to the main refinancing operations of the Eurosystem.

III. Managing financial crises[1]

The crisis type (liquidity or solvability) determines the distribution of the responsibilities for crisis management among the Eurosystem, the national central banks, the monitoring authorities and the finance ministers.

During a general liquidity crisis, the CBE can contribute to a reset of the efficient functioning of the monetary market by means of the operations of getting cash and by using the operational procedures settled by the Eurosystem. The crediting institutions lacking liquidity, though being solvable, can resort temporarily and in exchange for appropriate guarantees to the emergency facility (emergency liquidity emergency) offered by the Central National Bank to prevent and limit the potential systemic effects generated by the contagion among other financial institutions.

[1] Monthly Bulletin-10th anniversary of the ECB (May, 2008) ;

In the event of a crisis of solvability, the main responsibility for managing and solving the crisis is held by the finance minister, who decides on providing or refusing the financial help, and by the supervision authorities, which can take exceptional measures of supervision to stabilize the institution in need or can decide to liquidate it.

Irrespective of the nature of the financial crisis (of liquidity or solvability), the Eurosystem can back up the efforts of managing the crisis because of its expertise and analytical knowledge obtained by monitoring the financial stability and by evaluating the potential channels of the financial unbalance inside the financial system and the possible effects on its stability.

During the past ten years, there have been taken measures to consolidate the communitarian agreements regarding crisis management. The Eurosystem has contributed actively to three main domains:

1. the clarification of the legislative framework regarding crisis management, by the **Order for capital activation (2006)** and the **Order concerning financial conglomerates (2002)**;

2. the permanent spread and improvement of the voluntary cooperation agreements among the authorities as cooperation agreements at the level of the EU;

3. crisis simulation exercises at the level of the EU and the Eurosystem in order to consolidate the existing legislation, the non-official agreements and the improvement of the crisis solving knowledge.

As for the consolidation of the financial stability agreements in the euro area and in the EU, the Eurosystem has had the following contribution:

1. the Eurosystem has taken action at the level of the euro area to stimulate and maintain the stability of the financial system, to monitor and evaluate the financial stability as well as the market operations meant to limit the financial shocks and the tensions on the monetary market in the euro area;

2. the Eurosystem backs up the policy of the national authorities regarding the monitoring and evaluation of the financial stability, financial supervision and crisis management.

In 2005 there was concluded an agreement between CBE and the EU state members (updated in 2008) called "The cooperation agreement among the financial supervision authorities, the Central Banks and the Finance Ministries in the EU regarding the transnational financial stability "whose objective is to assure cooperation in case of financial crisis among the supervision Authorities, the Central Banks and the Finance Ministries by appropriate procedures of exchanging information and evaluation, with a view to facilitating their functions and to preserving the stability of the financial system of the individual Member States and of the EU as a whole.

The cooperation between the Parties (stipulated in the Agreement)[1], both in time of crisis and in normal times, will imply:

- setting an appropriate framework for cooperation in order to prepare common solutions and actions able to manage the potential negative effects of a crisis;
- exchanging relevant information to prevent, manage and solve a systemic transnational crisis, including evaluations that can enable the relevant Parties to assess promptly the systemic nature and the transnational implications of the crisis by using the common framework for systemic assessment.;
- coordinating public communication;
- setting up emergency plans, resilience tests and simulation exercises included.

IV. Future challenges

The financial stability of the EU is developing and needs extra improvement to be in accordance with the progress of financial innovation and integration. In the future, the Eurosystem is planning to focus on the following approaches:

- the appropriate understanding of the financial system, which is very complex and prone to fast changes; the adoption of measures that enable a more profound analysis of the interdependence of the economic and financial sectors, as well as the progress of the macro crisis simulation techniques
- providing quality consultancy regarding the development of the communitarian agreements of financial supervision and regulation;
- keeping the good pace of the communitarian agreements regarding crisis management;
- stimulating permanent cooperation between the central banks and the communitarian authorities, especially concerning the main financial groups that perform transnational transactions. The fast information exchange regarding the important evolutions and the risk profile of these groups must be a continuum as it is an essential part in crisis management.

The world economic and financial crisis (especially the Greek one) can be the greatest challenge for the EU and that is why the "European model", which supposes the active involvement of governments in economy, in the supervision of the financial system, of the industry and the labour market, of the health insurance and the pensions system, translates in fact the financial and economic ability of the member states to face it.

[1] The cooperation agreement among the financial supervision authorities, the central banks and the finance ministers in the EU regarding transnational financial stability – Bruxelles, 1 June 2008 .

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