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The Development of the Division of Labour between the ECB and the NCBs

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1. Introduction

Mr. Duisenberg, the first President of the European Central Bank (ECB), said in a speech he delivered in April 1997 at the Spring Meeting of the Institute of International Finance in Washington that the major challenge for the ESCB will be how the centre, i.e. the ECB, and the National Central Banks (NCBs) will relate to each other in the context of a centrally determined monetary policy and how the skills and expertise of the NCBs can best be used, without impairing the single nature of monetary policy. The European System of Central Banks (ESCB) will be characterized by central and decentral elements – the challenge will be to ensure the appropriate balance (Duisenberg, 1997).

This paper tries to give an outline on the development concerning the division of labour between the ECB and the NCBs, identifying the underlying developments and trends, since the inception of the Eurosystem. Hence, the focus is on the twelve Eurosystem NCBs and the tasks to be carried out by the Eurosystem. With a view to the different strategies and options for the division of labour the paper tries to capture not only the institutional but also the business aspects related to the different tasks. The identification of driving forces behind the developments in the division of labour and some conclusions round off the picture.

The Treaty on the European Union (in the following referred to as the Treaty) specifies very clearly the tasks to be carried out by the ESCB/Eurosystem, but in most cases is not specific about which part of the system should undertake them.

When looking at the terms used to describe the division of labour *centralisation* means that the ECB is solely responsible on the operative side for a business area and *decentralisation* means that all NCBs are collectively responsible for the operational implementation of a task or function for the Eurosystem.

As there are several choices for the division of labour under the decentralised approach, the term *specialisation* is used in case a specific task within the Eurosystem is delegated by the ECB Governing Council to be performed by one or a group of NCBs for the whole system. Up till now there has been no real

coordinated specialisation, but specialisation took place only on a voluntary basis. Nevertheless, the intention to generate synergies and to cooperate as much as possible is specifically mentioned in the organisational principles of the ESCB (ECB, 2005f). *Pooling* means that one or more NCBs together provide certain services for the whole Eurosystem on a collective basis. The term *consolidation* describes a reorganisation process within a decentralised approach that leads to a concentration within a few processing centres, but coordination takes place.

2. Basic Tasks of the ESCB

The basic philosophy in organising the Eurosystem is to have all decisions taken centrally by the ECB Governing Council. In this way uniformity of the single monetary policy can be ensured across the euro area. The implementation of decisions – that is operations, which in practice account for most of an NCB's work – is effected by the NCBs on a decentralized basis, coordinated by the ECB Executive Board (Liebscher, 1998) and by the federally organized structure of 13 ESCB/Eurosystem committees. The ECB and the NCBs are integral parts of a whole that is guided by a common set of rules, objectives and duties in both its internal and external relations. This underlines the federal character of the ESCB/Eurosystem and the institutional role of the NCBs as equal partners (Liebscher, 1998) within the ESCB.

The following section looks at the current division of labour among NCBs and the ECB as well as reforms and strategic decisions for change since the inception of the ESCB/Eurosystem. The business areas analysed are based on those mentioned in the Treaty and the ESCB Statutes. Definitions in the Treaty and the ESCB Statutes are very broad and constitute a loose framework in which the ECB and the NCBs have margin for manoeuvre to determine a more detailed division of labour.

2.1 Monetary Policy Preparation

Monetary policy decision making itself is centralised within the ECB Governing Council and is characterised by a team effort with a strong, but not dominant centre. The decisions are based on input provided by both the ECB and the NCBs.

Monetary policy preparation comprises the monitoring of (regional) economic development, forecasting, the preparation of economic, monetary and financial indicators, research and publication as well as econometric modelling. Research and Policy Departments of NCBs prepare Governors for ECB Governing Council meetings in their personal capacity on a national level on the basis of the ECB's aggregate data. Here the expression of alternative points of view is an important strength of a system of central banks (Goodfriend, 2000). Furthermore, the Governing Council needs to rely on regional information and intimate knowledge the NCBs have of their respective countries. Some NCBs have developed a

specialization, like the Banque Nationale de Belgique providing a leading business indicator.

The diversification of research within a system of central banks brings different analytical perspectives to monetary policy deliberations. This also gives to very active and engaged NCBs room to look into special topics and excel as experts in those topics. NCBs do not have to voice an opinion on everything and this might give a small NCB the competitive edge on some issues over larger NCBs with more research staff (Hochreiter, 2000). As to the division of labour among the individual NCBs, there is no general rule. Any specialisation so far is on a voluntary basis. NCBs have also specialised in economic knowledge concerning geographical areas with which they share or have shared special relationships, i.e. OeNB, Suomen Pankki, Banco de España.

Goodfriend (2000) points out, that the staff at the centre needs to take the lead in developing a macroeconomic framework within which diverse policy views can be expressed and debated productively.

Within the Eurosystem the development of a Monetary Policy Transmission Network and Inflation Persistence Network are good examples for such a cooperation.

2.2 Monetary Policy Implementation

The Governing Council of the ECB is responsible for formulating monetary policy, while the Executive Board of the ECB is empowered to implement monetary policy according to the decisions made and guidelines laid down by the Governing Council.¹ To the extent deemed possible and appropriate and with a view to ensuring operational efficiency, the ECB has recourse to the NCBs for carrying out operations which form part of the tasks of the Eurosystem. In fact, the Eurosystem's monetary policy operations are executed by NCBs under uniform terms and conditions in all Member States (ECB, 2005a).

The decentralised implementation ensures, that all financial institutions subject to minimum reserve requirements in the euro area are able to participate in standard open market operations and can access the standing facilities (ECB, 2002). It also ensures an element of continuity for counterparties as they can hold accounts at their NCBs. It also embodies an element of insurance against disasters, by operating from many locations across the monetary union. Finally, ongoing contact to market participants helps in the formulation of monetary policy and in the case of some NCBs in their supervisory responsibilities.

This business area, especially with a view to liquidity management, could easily be influenced by structural factors, such as increasing consolidation within the banking sector as well as an increase in cross-border mergers in the euro area. As

¹ Protocol on the Statute of the European System of Central Banks and of the European Central Bank, Article 12.1.

to a future subdivision of tasks, there is potential for specialisation or consolidation of operations in one or a few locations as the usefulness of implementing monetary policy from every NCB might diminish (Wellink, 2002).

2.3 Foreign Exchange Operations and Reserves Management

Contrary to the Federal Reserve System the Eurosystem handles its foreign exchange operations in a very decentralised manner. Currently, the NCBs are responsible for managing foreign exchange reserves on behalf of the ECB according to the instructions regarding acceptable instruments and benchmarks given by the ECB Governing Council (ECB, 2000) but according to their own risk preference.

2.4 Payment Securities and Settlement Services

Payment systems differ across the euro area. In this context, it is useful to make a distinction between wholesale and retail systems. Each NCB has its own wholesale payment system, based on their existing technologies and the European payment system TARGET (Trans-European Automated Real-Time Gross Settlement Express Transfer System) provides a common interface (16 national RTGS systems and the ECBs payment mechanism). TARGET works effectively as one pan-European system, but national differences remain.

Initially, even before EMU, it was decided that harmonisation should be minimal. But the heterogeneous nature of TARGET raised problems of both, efficiency and cost, i.e. difficulties with decentral components and software.

The ECB Council then decided in October 2002 to develop TARGET 2. It will replace the decentralised technical structure of the current TARGET system by a single technical platform (Single Shared Platform – SSP). It will feature new functionalities, designed to meet the future needs of financial markets that users requested in public consultation held in early 2003, and the Eurosystem is firmly committed to delivering TARGET 2 in 2007.

The most important innovation is the pooling of the technical infrastructure. Three Eurosystem central banks – Banca d'Italia, Banque de France and Deutsche Bundesbank – jointly provide the basis for the SSP and will operate it on behalf of the Eurosystem. The participation in TARGET 2 will be direct or indirect via a link to a direct participant (ECB, 2005b).

A trend towards consolidation can also be seen in securities settlement, especially due to the ongoing work of the European Commission and the ECB concerning the harmonisation of the infrastructure (ECB, 2005c).

3. Other Tasks of the ESCB

3.1 Advisory Functions

The Treaty confers advisory functions to the ECB and its governing bodies on a wide range of subjects. Normally the advisory functions are coordinated by written procedure. The central function of the ECB is due to its role of writing the first drafts and hence it has the possibility to define content and volume. The NCBs are certainly given the possibility to cooperate and correct and can still influence the final product. Altogether the volume of advisory functions increased over time.

3.2 Financial Stability and Prudential Supervision

The ECB, together with the Eurosystem, has three tasks in this field: financial stability monitoring, provision of advice and promotion of cooperation.² The Treaty does not confer any specific supervisory competences to the ESCB/Eurosystem as such.

The financial stability monitoring in order to assess the possible vulnerabilities in the financial sector, and its resilience to potential shocks is done in collaboration of the ECB with the NCBs and supervisory agencies. They are all represented in the ESCB Banking Supervision Committee.

Concerning prudential supervision not all NCBs are the leading authority in their countries. But, by explicitly assigning a role to the ESCB, rather than the ECB, the Treaty gives all parts of the system a role, although this institutional set-up requires creative solutions. In this respect an increasing harmonisation of standards among the NCBs and supervisory authorities of the ESCB as well as a better exchange of information is well under way. These are logical developments characterised by cooperation and coordination but not tendencies for centralisation.

The integration process in the sector of financial supervision is not directly driven by the Eurosystem, but by national as well as EU legislation and decision making, Basel II and the emergence of new national supervisory authorities. Hence, here is no Eurosystem driven division of labour.

Although the increasing internationalisation of banks will determine supervisory arrangements in the future, it is not obvious that centralisation will be the most effective response. Financial structures still differ widely across Europe and also the absence of any fiscal union plays a role here, as any major financial crisis is likely to have implications on national budgets.

² Article 105.4 and 105.5 of the Treaty and in Article 25.1 of the Statute of the ESCB.

3.3 Banknotes and Coins

Legally, both the ECB and the NCBs of the participating countries have the right to issue euro banknotes. In practice, only the NCBs physically issue and withdraw euro banknotes (as well as coins). The ECB does not have a cash office and is not involved in any cash operations. The legal issuers of euro coins are the participating countries. At the euro area level it is the European Commission that coordinates all coin matters. Hence, the production of coins is completely decentralised as decisions are taken in the Economic and Financial Committee (EFC).

Each NCB was responsible for deciding on the production arrangements for its initial supply of euro banknotes. Then in April 2001 the ECB Governing Council decided that, in the years following the cash changeover, production of euro banknotes will take place according to a decentralised production scenario with pooling. This means that, as of 2002, each NCB has been responsible for the production of an allocated share in the total production volume of euro banknotes in only a few denominations. Each NCB defines its own procurement rules for its own allocated production. Here certainly the NCBs bear in mind the interests of its print works.

In September 2004, the ECB Governing Council adopted a Guideline (ECB, 2004) setting out how euro banknotes would be procured in the future, taking into account the fact that several NCBs within the Eurosystem have in-house printing works or use private printing works rather than seeking tenders for the euro banknote production allocated to them. The single Eurosystem tender procedure establishes an open and transparent procurement system in accordance with the principle of an open market economy with free competition favouring an efficient allocation of resources.

In respect of the Eurosystem's role and responsibilities in the cash cycle, the ECB Governing Council agreed upon common principles and objectives in December 2004. It thereby provides a reliable framework for its partners in the cash cycle – i.e. the banking industry and cash-in-transit companies. In line with the principle of decentralisation, the NCBs are responsible for implementation at the national level, taking into account their respective national economic environments and banking structures, the existing NCB branch network and the relative shares of cash payments and/or longer term agreements. Altogether the consolidation of processes and systemic improvement strive to further enhance its effectiveness and efficiency in all areas, taking advantage of all the experience available and exploiting potential synergies and economies of scale wherever possible (ECB, 2000).

Concerning the design, security features and quality control a specialisation is possible, although only in cooperation with the ECB. The OeNB can serve as an example here, with Mr. Kalina winning the design contest for the euro, as well as

its role concerning counterfeiting, as it is responsible for the upkeep of the Counterfeit Monitoring System database.

3.4 International Cooperation

The Treaty³ states that the ECB should be the system's representative vis-à-vis third parties and the ECB Governing Council decides how this is arranged in practice. The multilateral international cooperation is clearly decentral with cooperation as normally the NCBs are represented in the international organisations and the ECB participates as an observer. Individual euro area countries remain responsible for the economic policies other than monetary and exchange rate policies, even though coordination mechanisms have been strengthened at the European Community level (e.g. in the areas of fiscal and structural policy). This means that the involvement of the ECB, the European Community and individual EU Member States in the process of international cooperation varies depending on the mandates of the relevant international organisations and fora as shown in the table below.

3.5 Statistics

In compiling statistics, the ECB is heavily supported by the NCBs. The NCBs (and, in some cases, other national authorities) collect data from credit institutions and other sources in their respective countries and calculate aggregates at the national level, which they send to the ECB. The ECB then compiles and disseminates the aggregates for the euro area (ECB, 2005d).

In general statistics are a growth sector due to the demands of the ECB which are often more ambitious than the present EU requirements. With regard to the need of extensive resources as well as to the cooperation with other national entities, any other division of labour than decentralisation seems difficult right now. Over the long term the arguments for national data collection might only diminish if national borders become less important from an economic perspective.

³ The Treaty, Article 111, Articles 3, 4, 5.1 of the Statute of the ESCB.

Table 1: Main International Organisations and Fora Involved in Economic Policy Cooperation

Organisation or Forum	ECB	NCB	Other
International Monetary Fund (IMF)	Observer Status	With the exception of Austria and Finland, where the NCBs are the competent authorities, responsibility is shared with the Government	184 Member States
Organisation for Economic Co-operation and Development (OECD)	The ECB acts as a separate member of the European Community delegation alongside the Commission	Co-representation with ministries in relevant committees	Ministries of 29 Member States
G7 ministers and governors	The ECB President represents the euro area when macroeconomic policy and exchange rate issues are discussed	Central bank governors of Canada, France, Germany, Italy, Japan, the United Kingdom and the United States	Finance ministers of the 7 countries, President of the Eurogroup
G10 ministers and governors	The ECB President has observer status	Central bank governors of Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States	Finance ministers of the 11 countries

Table 1 continued: Main International Organisations and Fora Involved in Economic Policy Cooperation

G20 ministers and governors	The ECB President	Central bank governors of the G7 countries plus Argentina, Australia, Brazil, China, India, Indonesia, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey	Finance ministers of the 19 countries; the President of the World Bank, the Managing Director of the IMF and the Chairmen of the IMFC and the Development Committee; the President of the Eurogroup
Bank for International Settlements (BIS)	ECB since 1999	50 central banks	
Basel Committee on Banking Supervision (BCBS)	Observer Status	G10 central bank governors	G10 finance ministers
Committee on Payment and Settlement Systems (CPSS)	ECB	G10 central banks plus Hong Kong SAR and Singapore	G10 finance ministers
Committee on the Global Financial System (CGFS)	ECB	G10 central banks	
Gold and Foreign Exchange Committee (GFEC)	ECB	G10 central banks	

Source: ECB (2001), OeNB.

4. Driving Forces

4.1 Treaty Framework and Decisions by the ECB Governing Council and the EU

The basic philosophy in organising the Eurosystem is that monetary policy can only be pursued centrally – it is indivisible by its very nature (Selmayer, 1999). All decisions are taken centrally by the ECB Governing Council. This way uniformity of the single monetary policy can be ensured across the euro area. In conducting operations within the ESCB's field of competence, the ECB relies on the NCBs whenever possible and appropriate. This apparently quite straightforward structure nevertheless allows ample room for manoeuvre in actual practice. It is up to the ECB Governing Council to decide the exact boundaries of the division of labour. The Mission Statement, Strategic Intent and Organisational Principles (ECB, 2005f) represent a first step towards defining general principles for such a division of labour.

In addition of course the EU legal framework has far reaching implications for the Eurosystem. The institutional set up of financial supervision, the areas of public procurement or competition can serve as examples here.

4.2 Financing the System

As NCBs are financially independent, they could theoretically do what they want to do – as long as it doesn't conflict with the Treaty and the decisions taken by the Governing Council - in and for the whole Eurosystem and then endorse their own budget for this activity. Such decisions might depend on the location of an NCB, the image it wants to project or what is permissible in its own political environment and national legal framework. They have the financial leeway to conduct their proper business or for example to pursue specialisation.

4.3 National Institutional, Legal and Political Framework.

The institutional set up of NCBs differs widely within the Eurosystem due to national requirements and historical development. It follows that NCBs work with a given organisation when formulating strategies and options for their particular "niche" within the Eurosystem. Usually they are trying to capitalise on their traditional strengths and special points of interest.

Furthermore, the diversity of national institutional structures has an essential impact on the NCBs role not only as domestic policy actors but also as key players within the Eurosystem. National conglomerates in the banking sector also impact the organisation of liquidity management in commercial banks and as a consequence the respective NCB. Another example are the different roles the

individual NCBs play in the field of banking supervision, not a competence of the ESCB per se, but which involves a lot of coordination within the system. What's more, the less political union we have, the more of a role there is for NCBs as national policy actors.

4.4 Business and Operational Aspects

Business and operational aspects are certainly also a decisive factor in the development of the division of labour. Often sheer logic prevails. The size of an NCB in terms of financing and resources certainly matters concerning costs, quantity as well as quality. Market power as well as political power must not be neglected.

Economies of scale might work to the advantage of bigger NCBs. The pooling offered by the Deutsche Bundesbank, the Banca d'Italia and the Banque de France for TARGET 2 stands as an example.

Competition among institutions, for example in the research activities of the ESCB, can be seen as an incentive for new ideas and results, enhancing the quality of the decision making process and possibly leading to specialisation or consolidation.

Smaller NCBs might ultimately be less interested in keeping up a full range of functions, as their capacities could be overextended. Indeed there are decisions that NCBs can, but need not fulfil certain operative functions. In this context however, smaller NCBs might act as quality leaders in other areas and make strategic use of their competitive advantage in for example geographic location and knowledge of staff. However, other influences like the local conditions of employment could slow down the flexibility of reaction to these new challenges.

5. Conclusions

All in all the Treaty provides a flexible enough framework to accommodate all sorts of different degrees of division of labour among the ECB and the NCBs, naturally depending on the task to be fulfilled by the Eurosystem. So far the decisions of the ECB Governing Council guarantee a decentralised approach which has proven to work very effectively. However, the decisions give enough leeway to NCBs for positioning themselves within the division of tasks and functions. To a certain extent it is up to them to define their proper approach to specialisation, pooling, etc. It can also be seen that there is not one best system concerning the division of labour in order to achieve effectiveness and efficiency in implementing the tasks of the Eurosystem. The different tasks and functions of the Eurosystem show each a different pattern of centralisation, decentralisation, specialisation, pooling and consolidation. Changes in the division of labour among NCBs and the ECB have occurred at different speeds and are as a consequence in different stages of development within the Eurosystem. Finally, it can also be said that size,

political, business and operational aspects matter for the future positioning of the individual NCBS.

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