Mr. Fazio reports on the Bank of Italy and the European System of Central Banks Statement by the Governor of the Bank of Italy, Dott. Antonio Fazio, before the Treasury, Budget and Planning Committee of the Chamber of Deputies, in Rome on 12/2/98.

The results the Italian economy has achieved in the past five years are attributable to the combined operation of fiscal and monetary policy and to wage moderation.

In late 1992 and early 1993 the restrictive stance of monetary policy prevented expectations of rising prices, fuelled by the decline in the external value of the lira and the abrupt change in the exchange rate regime, from translating into actual inflation. A substantial contribution to this result came from low wage growth and budgetary measures that impinged on the structure of the main components of government spending.

Conditions in the economy became difficult again during 1994: the state sector borrowing requirement was overshooting the targets and demand was growing rapidly, with the result that inflationary pressures developed. In December 1994 and the first few months of 1995 domestic political factors and the repercussions of the Mexican crisis on the foreign exchange and financial markets aggravated the situation. Official rates were raised three times: in August 1994, at the first manifestation of price tensions; in February 1995, in conjunction with supplementary fiscal measures; and in May of the same year, when doubts arose about the curbing of inflation.

The monetary tightening, the fiscal measures of early 1995 and the stabilization of the exchange rate had a positive influence on inflation expectations and long-term interest rates.

Monetary policy maintained a restrictive stance throughout 1995 and in the first half of 1996, with the aim of subduing inflation expectations and bringing the rate of increase in prices into line with that prevailing in the other leading industrial countries.

In July 1996 a start was made on lowering the official rates. The reduction was prudent and calibrated above all in relation to the decline in expected and actual inflation. This approach resulted in a constant inflow of funds from abroad for purchases of government securities; by offsetting the large outflows of Italian capital generated by the need for portfolio diversification, these inflows contributed to the stability of the exchange rate of the lira.

The progress achieved made it possible for the lira to rejoin the exchange rate mechanism of the EMS in November 1996.

The caution employed in relaxing monetary conditions meant that Italy’s financial and foreign exchange markets were not affected more than marginally in 1997 by the tensions that emerged at the international level in connection with the crisis in East Asia and the vicissitudes of some important European countries or by those attributable to domestic political developments.

Today the Bank of Italy’s reserves comprise more than 2,500 tonnes of gold and foreign assets, net of repurchase agreements, worth 82 trillion lire, compared with ó trillion in 1992. Underlying the lira’s solidity is the return to balance between Italy’s external assets and liabilities.

At the end of 1992 Italy had external claims of 600 trillion lire and external liabilities amounting to 770 trillion. The net debt of 170 trillion was equal to 11 per cent of GDP.

Thanks to the succession of surpluses recorded on the current account of the balance of payments, at the end of 1997 Italy’s overall net external position was once more broadly in balance.

Last September some 470 trillion lire of government foreign debt, consisting mostly of government securities held by non-residents, were matched by net external assets of more than 350 trillion held by the non-bank private sector, about 100 trillion held by the Bank of Italy and smaller amounts held by banks and other financial operators.

The Bank of Italy and the European System of Central Banks

It has been agreed within the Community that the decisions concerning the start of monetary union – in particular, those involving the countries that will adopt the single currency from the start – will be taken in the early part of the month of May.

With the introduction of the single currency, the task of formulating monetary policy will be transferred to the European System of Central Banks, comprising the central banks of all the participating countries and the European Central Bank.

The Treaty establishing the European Community, as amended at Maastricht, provides a broad outline of the internal organization of the ESCB. The preparatory work carried out by the European Monetary Institute since the signing of the Treaty has focused on these aspects.

The national central banks will be entrusted with the task of implementing within each country the monetary policy decided at the Community level.

The central banks of the participating countries will continue to be responsible for all the functions they are entrusted with under national laws; in Italy these include banking supervision, the supervision of markets, the safeguarding of competition in the credit market and, jointly with the European Central Bank, oversight of the payments system.

The systemic crises in foreign markets have strengthened the view that banking supervision complements monetary policy in determining conditions of stability in financial and credit markets.

The primary objective of the common monetary policy is price stability. The mandate, clear and unequivocal, given to the European System of Central Banks is based on two tenets held by the drafters of the Treaty: that the stability of the value of money is a public good which does not hinder, but rather fosters, sustainable growth of the real economy; and that maintaining stability depends crucially on the operation of monetary policy.

The European System of Central Banks will enjoy complete autonomy; it will regularly provide information on its activities and report on them to the other Community institutions. In particular, the European Central Bank will be required, pursuant to Article 109b of the Treaty and Article 15 of the Statute of the European System of Central Banks, to publish periodic reports on the activities of the ESCB, with a description of the current and future stance of monetary policy. The European Parliament will be able to debate these matters and invite the President and the other members of the Executive Board of the European Central Bank to be heard by its competent committees.

In particular, the need for a “single” monetary policy will have to be reconciled with the principle of “subsidiarity”, which has also been embodied in the Statute of the ESCB and is intended to permit the highest possible degree of decentralization in operational terms.

More specifically, provision is made for a division of tasks along the following lines:

- the decision-making powers in monetary policy matters, especially with regard to interest rates and compulsory reserves, will be centralized in the European Central Bank. The ECB will exercise these powers through the Governing Council, comprising the Governors of the national central banks and the Executive Board, composed of the President, the Vice-President and four other members. The Executive Board will be responsible for implementing the decisions of the Governing Council on a continuous basis;
- the operational implementation of monetary policy will be entrusted to the national central banks.

Each national central bank will thus have two tasks: it will contribute, through its Governor, to the decisions of the Governing Council; and it will implement these decisions in its own country.

Operations in the money and foreign exchange markets will normally be carried out by the national central banks.

Within this framework, the Bank of Italy will continue to carry out all the operational functions that it currently performs. The procedures for conducting monetary control operations will be different in part from those used today; the draft legislative decree currently under discussion in Parliament is designed to permit the necessary changes.

Legal convergence

The Treaty requires each member state to make its national legislation, and especially the provisions concerning its central bank, compatible with the Treaty and the Statute of the European System of Central Banks. In particular, the Treaty requires each member state to ensure that its central bank is independent from the government and all other political bodies; the necessary reforms must be enacted before the introduction of the single currency.

Within the general framework laid down in the Treaty, the European Monetary Institute and the Commission have done valuable work in analyzing and interpreting the relevant provisions and providing clear indications of the criteria to be followed in adapting national legislation to Community law, not least in view of the need for the latter’s uniform application throughout the European Union.

The key requirements of central bank independence with a view to a country’s adoption of the single currency are:

- the task of pursuing price stability as the primary objective;
- complete autonomy in the management of the monetary instruments, interest rates and monetary and credit aggregates, for the purpose of defending the internal and external value of the currency.

Some of the provisions of the draft legislative decree are aimed at strengthening the Bank of Italy's independence, the essentials of which are in fact already provided for in Italian legislation.

At a higher level there is the proposal of the Joint Parliamentary Committee on constitutional reform for the Bank of Italy to be given constitutional status by affirming the central bank's independence and autonomy in the performance of its monetary and supervisory functions in the Constitution.

The integration of the national central banks in the European System of Central Banks is to be achieved by linking the implementation at national level of measures concerning official interest rates, compulsory reserves and open-market operations with the decisions adopted by the European Central Bank.

It is important to stress that, in conformity with the Statute of the European System of Central Banks, the participation of the Bank of Italy in the System will • not affect the performance of the other tasks that it is assigned under national legislation, especially those related to banking supervision.

The draft legislative decree contains the provisions needed to ensure the compatibility of Italian legislation with the Treaty and the Statute of the European System of Central Banks. In addition to the competent Italian Parliamentary committees, it has been submitted, as required, to the European Monetary Institute for its opinion. The provisions guaranteeing the integration of the Bank of Italy in the ESCB will mostly come into force at the time the single currency is adopted.

The Statute of the Bank of Italy will be modified in accordance with the legislative decree under discussion. The Bank's Board of Directors has already approved the proposed amendments, which will be put to the Extraordinary General Meeting of Shareholders to be held on 19 March: they will be rendered compatible with the final text of the legislative decree.

The amendments to the Bank's Statutes will then follow the procedure laid down for their approval by the President of the Republic.

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In Italy the monetary policy approach that has been followed in the last few years, and will be maintained in the coming years, is aimed at convincing market participants, workers and businessmen that increases in income can only be achieved by expanding economic activity.

The action taken on the monetary front, of necessity extremely rigorous at times, has made a major contribution to the convergence of Italy's economy towards those of European countries with a more firmly established tradition of stability.

The decisions that will be taken by the European Central Bank will have maintaining price stability as their objective.

Labour market, incomes and fiscal policies will increasingly be the only ones available to promote the competitiveness and profitability of Italy's enterprises, and growth in production and employment. They will have to give renewed impetus to productive investment.

The ample availability of savings, of which a large part is invested abroad at present, makes this possible.

The revival of economic activity in Europe as a whole cannot be based on manoeuvres to enhance competitiveness through the exchange rate of the common currency; such action would be in conflict with the primary objective of monetary stability. This will have to be underpinned by a strong productive system, to be achieved by curbing budgets and taxes, boosting investment and making more flexible use of the factors of production. These are the indispensable conditions for achieving faster growth and creating new employment.