

Prohibition of monetary financing of the public sector

Art 101 EC:

Central banks must not finance the government of other bodies of the public sector (primary markets)

Exception for supply of reserves to public credit institutions, if same treatment as private credit institutions

Objectives:

- **helps to ensure financial discipline in the framework of the single monetary policy (balanced budget – price stability)**
- **protects central bank independence: central banks' monetary policy operations shall not be influenced by public financing**

No bail-out

Art 103 EC (no-bail out clause):

The EC (or a MS) not liable for commitments of public authorities, public bodies, public undertakings of a (another) MS

Objectives

- ensuring that the EC or a MS not affected by imprudent policies of a (another) MS*
- shielding other Gvts or EC institutions (ECB, CMSN, ...) against systemic impact of possible default by a euro area MS*

Prohibition of monetary financing of the public sector

Regulation 3603/93 addresses two types of questions:

- the nature of credits which fall or not under the prohibition**
- practices implying central bank credit but which should not be prohibited given their strictly fiscal nature or their small size**

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Regulation (EC) 3603/93

The nature of credits which fall or not under the prohibition

- **existing stocks of debt: allowed under conditions**
- **purchases of public debt instruments on the secondary market: allowed**
- **cross-border purchases: not allowed on primary markets**
- **definition of the public sector: not only Central Gvt, NCBs are excluded**

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Regulation (EC) 3603/93

Practices implying central bank credit but which should not be prohibited given their strictly fiscal nature or their small size

- **intra-day credit: allowed if no extension into overnight credit**
- **collection of cheques: fixed lags are determined**
- **holding of coins: ceiling of 10 % of coins in circulation**
- **credits in the fulfilment of international monetary obligations: BoP support from IMF**

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The LOLR function:

- **granting of emergency loans by NCBs to credit institutions in exceptional circumstances, aiming at:**
 - *safeguarding the stability of the financial system*
 - *maintaining bank liquidity*
- **adequate safeguard clause needs to be inserted, so as to avoid that:**
 - *the NCB might eventually bear financial costs which are to be borne by the state (monetary financing would be involved)*
 - *the financial independence of the NCB be at risk*

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Deposit guarantee systems (DGS):

- the granting of loans by NCBs to DGSs might be problematic
- adequate safeguard clause needs to be inserted, so as to avoid that:
 - *the NCB might eventually bear financial costs which are to be borne by the state (monetary financing would be involved)*
 - *the financial independence of the NCB be at risk*

Prohibition of privileged access of the public sector to financial institutions

Art 102 EC:

Gvts not allowed to circumvent market discipline and the locking of their access to the central bank (Art 101 EC) by obliging financial institutions to provide them with (often cheap) financial funds.

Another essential element of the financial discipline necessary for the functioning of the single monetary policy.

Prohibition of privileged access of the public sector to financial institutions

Art 102 EC:

Relates to various types of legislation

- *social security funds;*
- *pension funds;*
- *deposit guarantee schemes;*
- *credit institutions;*
- *investment companies;*
- *insurance companies;*
- *- etc...*

Prohibition of privileged access of the public sector to financial institutions

Council regulation (EC) 3604/93

great variety of national traditions, institutional particularities & country-specific practices in the financial field: certain should be preserved when:

- *principal objective not to supply funds to the public sector in “non market” way***
- *effects on the financial discipline of the government is negligible***

Prohibition of privileged access of the public sector to financial institutions

Council regulation (EC) 3604/93

secondary legislation provides three definitions

- privileged access: limited to obligations or encouragements in the form of legal instruments**
- prudential considerations: restrictive interpretation - should not become a way to circumvent Art 102 EC**
- financial institutions: see supra + catch-all clause**