Too good to be true – the first three months. (Part I)

In March, I attended a meeting of Group Euro, a collection of economists, lawyers, ex-civil servants and IT types whom the European Commission occasionally calls upon when it is asked to provide lecturers by various bodies. These are usually interesting occasions, since I get to meet all sorts of people who are actually involved in the daily developments involving the euro, swap stories and so on and generally they will give a pretty candid view of what's going on.

What I learned was that by far the biggest single problem both to date and for the future is, in fact a systems problem. Luckily – and highly unusually – it doesn't look as though we IT types will be held responsible. Pretty remarkable in its own right I should say.

The problem is the lack of a pan-European clearing system for transfer of small amounts of money.

What is happening is that Germans, Spaniards, Austrian and the rest have believed all of the stuff about there being one currency in Europe and have begun to behave as though the European currency area is just the same as the one that they were used to, only it's bigger. Sadly, while they may be correct about the strict legalities of the currency, they are wrong when they assume (and many do) that the infrastructure for handling their money has suddenly grown to cover the whole euro zone.

There were tales of transfers of DM 100 costing DM 40 and even some transfers in Spain costing more than the value of the amount being moved. And this is despite the fact that transfers of, say, a billion euros will cost less than a euro when effected through TARGET.

The problem has two aspects, one presentational, the other structural.

During 1998, the European Commission published a recommendation that banks unbundle the cost of money transfer and the spread involved in exchanges between prospective 'in' currencies. Traditionally, European banks buried the operational cost in a wide spread between bid and offer prices, and took the difference between the funding cost and the price to the public to cover both currency risk and operational cost (and, of course profit). The idea was that when the euro arrived and the exchange risk disappeared, the operational cost would have become an accepted factor in changing notes. However, very few banks followed this agreement – presumably they thought that for such a short period there was little point.

However, a significant part of the European public thought that once the currency risk had disappeared – and therefore legally there could be no spread – the cost disappeared too! Unfortunately, as we can see, not all of the costs had disappeared.

Of course there was an element of ripoff-ism too! It seems that the cost in Irish banks fell roughly in proportion to the elimination of the currency risk (which was fairly significant because of the punt's strong association with sterling), but that in some Spanish banks the charges actually rose!

This is a problem which can be fixed fairly easily however, and we should expect to see the cost of swapping francs for marks come down to simply the operational cost.

But this is where the second, structural problem comes in. For while each European currency has its own local clearing system, there is no pan-European clearing system for small (i.e. not-TARGET-sized) amounts. And this threatens all sorts of problems. I shall be looking at these in my next article.