EU Communication

FUTURE OF 1 AND 2 EURO CENT COINS

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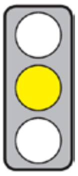
Centrum für Europäische Politik

KEY ISSUES

Objective of the Communication: The Commission is considering the withdrawal of 1 and 2 cent coins.

Affected parties: All citizens and companies, especially banks and retailers, mints.



Pro: (1) Examining cost differences between mints may reduce the losses made by the euro-states on the issuance of small coins.

(2) Abolition of small coins will save the time needed for payment by companies and consumers and reduce handling costs for banks and retailers.

Contra: (1) The rounding rules may reduce the incentive for retailers to pass on a cost reduction to the consumer. They may also result in a one-off rise in inflation if retailers use the opportunity to round more prices up than down.

(2) The EU does not have the competence to lay down EU-wide rounding rules.

CONTENT

Title

Communication COM(2013) 281 of 14 May 2013: Issues related to the **continued issuance of the 1 and 2 euro cent coins**

Brief Summary

► **Context and objective**

– In the Communication, the Commission considers four options for the future of 1 and 2 euro cent coins (hereinafter "small coins").
  - Option 1: Continued issuance of small coins,
  - Option 2: Reduction of the production costs of small coins,
  - Option 3: Gradual withdrawal of small coins,
  - Option 4: Quick withdrawal of small coins,
– About half of the euro-states make a loss on the issuance of small coins.
  - National governments manufacture the small coins and subsequently sell them at the nominal value, i.e. for 1 or 2 cents per coin, to the national central banks.
  - In about half of the euro-states, the production costs of small coins are higher than the nominal value [SWD(2013) 175, p. 30].
– Since the euro cash changeover in 2002, the euro-states have incurred a loss due to the issuance of small coins totalling approximately 1.4 billion euro. The Commission's estimate is based on the average production costs of five euro-states scaled up for the rest of the euro-states [p. 4; SWD (2013) 175, p. 19 et seq.].
– The loss incurred by the euro-states is also high because a comparatively large number of small coins have to be issued. Thus the ratio of small coins to the overall number of coins in circulation has risen from 31%, on the euro cash changeover, to 46% in 2012 [SWD (2013) 175, p. 10]. This is because consumers hoard their small coins which they receive as change at home rather than spending them because they regard them as valueless.
– Nevertheless, according to a 2012 survey, 66% of consumers think that there is just the right number of euro coins with different nominal values [SWD(2013) 175, p. 41].
– Banks and retailers face high handling costs due to the small coins.
  Handling costs are e.g. [p. 5; SWD(2013) 175, p. 18, 48]
    - storage and transport costs,
    - the cost of counting the coins and
    - acquisition costs for small coins; thus retailers have to pay additional handling charges of 40 cents for a roll of fifty 1 cent coins.
– The Communication is to give rise to a discussion between the various stakeholders.

► **Option 1: Continued issuance of small coins**

– The small coins remain legal tender without any changes.
– This option means [p. 3 et seq., SWD(2013) 175, p. 18]:
  - the euro-states continue to make a loss on the issuance of small coins which means continued higher taxes.
  - banks and retailers continue to have high handling costs due to the small coins so consumer prices remain higher.

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- **Option 2: Reduction of the production costs of small coins**
  – Small coins remain legal tender but their production costs are reduced.
  – The production costs are made up of the cost of (p. 4)
    - the raw materials,
    - manufacturing blanks and
    - minting.
  – Production costs can be reduced (p. 5 et seq.)
    - if the EU (which is responsible in this regard) reduces the cost of raw materials - which make up approx. 50-60% of the nominal value of the small coins - e.g. by using cheaper material such as stainless steel, and/or
    - if the Member States (that are responsible in this regard) reduce the cost of minting which vary greatly between the Member States.

    The Commission does not see potential for savings with regard to the cost of manufacturing blanks.
  – The Commission wants to examine whether differences in the cost of minting result from [SWD (2013) 175, p. 20 et seq.]
    - differences in the labour and/or capital costs,
    - inefficiencies in the minting processes of the mints and/or
    - the quasi-monopolistic position of the mints.
  – This option means [p. 6; SWD (2013) 175, p. 47]:
    - losses by the euro-states on the issuance of small coins will fall,
    - banks and retailers will continue to face high handling costs due to the small coins.

- **Option 3: Gradual withdrawal of small coins**
  – The issuance of small coins will cease but they would remain legal tender to begin with.
  – The legal tender of the coins will be withdrawn after four or five years when, in the Commission's estimation, "most" of the small coins will have disappeared - mainly due to the hoarding of coins by consumers (p. 7 et seq.).
  – From the time that issuance of the coins is stopped, the Commission wants to introduce legally binding rounding rules in order to ensure legal certainty with regard to payment [p. 7; SWD(2013) 175, p. 43].
    - At the cash till, the final amounts payable - but not the individual prices - will be rounded up or down to the nearest 5 cents in accordance with mathematical rounding rules.
    - Only the rounded final amounts will be payable
      - in cash, including small coins, and
      - by way of card-based payment.
  – This option means [p. 8; SWD (2013) 175, p. 45, 49]:
    - the euro-states will make no more losses because issuance of small coins will cease.
    - profit on coins in the euro-states could increase because the demand for 5 and 10 cent coins, on which the euro-states make a profit, is likely to rise.
    - handling costs of small coins for banks and retailers will fall over time.

- **Option 4: Quick withdrawal of small coins**
  – The issuance of small coins will cease and the small coins in circulation will be withdrawn within a fixed "short" time period, particularly via retailers and banks (p. 3). At the end of the period, the small coins will cease to be legal tender.
  – From the time that issuance of small coins is stopped, the Commission wants to introduce legally binding rounding rules (see Option 3).
  – This option means (p. 6):
    - banks and retailers will have the one-off cost of withdrawing the small coins.
    - the euro-states will make no more losses because issuance of small coins will cease.
    - profit on coins in the euro-states could increase because the demand for 5 and 10 cent coins, on which the euro-states make a profit, is likely to rise.
    - handling costs of small coins for banks and retailers will cease on expiry of the "short" time period.

- **Possible risk of inflation due to rounding rules**
  – There may be a one-off increase in inflation if retailers use the introduction of rounding rules as a one-off opportunity to round up their prices [p. 6; SWD(2013) 175, S. 26].
  – The perceived rise in inflation may be greater than the actual rise if retailers use the introduction of rounding rules as a one-off opportunity to round up the prices of items that are frequently purchased by consumers - such as food - more often than rounding them down [p. 6 et seq.; SWD(2013) 175, p. 27].
  – There may be a sustained rise in inflation if consumers expect sustained price rises in the future, either due to a one-off rise in inflation or perceived inflation or due to rounding up the final amounts at the till - even though prices will also be rounded down. Such a rise in inflation expectations leads to higher wage demands and wage agreements whereupon companies actually do increase prices. [SWD(2013) 175, p. 28]

– The Commission does not expect a significant risk of inflation due to the rounding rules because (p. 7)
  - only final amounts, not individual prices, will be rounded,
  - the final amounts will be rounded down as well as up,
  - an information campaign will aim to prevent rising inflation expectations and perceived inflation,
  - the introduction of the euro did not have significant impact on price and wage expectations and
  - studies and experience from other countries and the euro-states show that the impact would be limited; in Finland and the Netherlands, in particular, where the issuance of small coins has already been restricted, similar rounding rules had little or no impact on inflation.

Statement on Subsidiarity by the Commission

Even if individual euro-states cease the issuance of small coins and introduce rounding rules, only EU legislation is capable of abolishing the small coins as legal tender [SWD(2013) 175, p. 17]. If small coins are legal tender, retailers should have to accept them in payment of the rounded amount (Recommendation 2010/191/EU).

Policy Context

In 2012, the European Parliament and the Council spoke out in favour of a regular examination of the costs and public acceptance of the individual euro coins and banknotes [Recital 7 in conjunction with Art. 2 (2) Regulation (EU) No. 651/2012]. Following this, in 2013, the Commission conducted an Impact Assessment. Further Impact Assessments by the Commission are expected. In addition, the Commission is planning to publish a non-legislative proposal on minting. With Finland and the Netherlands having already restricted the issuance of small coins, the Belgian government is also planning to introduce rounding rules.

Options for Influencing the Political Process

Directorates General:	DG Economic and Financial Affairs
Committees of the European Parliament:	Economic and Monetary Affairs (leading)
Federal Ministries:	Finance (leading)

ASSESSMENT

Economic Impact Assessment

The Commission's assessment that, since the euro cash changeover, the euro-states have made a loss of up to 1.4 billion euro as a result of the small coins, should be taken with a pinch of salt: The assessment is only based on data from five euro-states. Since the cost per small coin varies substantially between the five states - from costs below the nominal value to costs four times higher than the nominal value - the Commission's calculation of the loss is dubious. What is more, one of the states examined - possibly a statistical blip - recorded very high production costs per small coin. The statistical method used by the Commission means that this state, because it is large and produces a lot of coins, has a greater impact on the estimate when it is scaled up than the other four states [SWD (2013) 175, p. 19 et seq.]. It is therefore highly likely that the loss of 1.4 billion euro determined by the Commission is too high. Although some euro-states make losses on the issuance of small coins, which are borne by the tax-payer, that is not sufficient reason to abolish them. Instead, the overall costs and benefits which the small coins bring to consumers and companies must be weighed up - on the one hand as users of the coins and, on the other hand as tax-payers.

Examining cost differences between mints, as proposed by the Commission in Option 2, **may** uncover inefficient minting processes and thus **reduce the losses made by the euro-states on the issuance of small coins.** In addition, it could also uncover inefficient minting processes with regard to other coins such as the 5 and 10 cent coins. This will not happen if the small coins are simply abolished as proposed in Options 3 and 4. In that case, inefficient minting processes in relation to other coins will remain in place.

The abolition of small coins - that is Options 3 and 4 - **will, on the one hand, save the time needed for payment by companies and consumers** because there will be fewer coins to be exchanged on each transaction. **The handling costs for banks and retailers will also go down.** This cost benefit can be passed on to the consumer by way of lower prices. **On the other hand, the rounding rules may reduce the incentive for retailers** to differentiate prices to the exact cent with regard to products where price differences of a few cents are critical for the consumer. Thus a retailer will, for example, have less incentive **to pass on a cost reduction** of 2 cents per piece **to the consumer** if, as a result, the price e.g. sinks from 65 cents to 63 cents and customers often only buy single items, such as at the bakery.

This incentive is also less if retailers decide, as a result of the rounding rules, to round all individual prices up or down to the nearest 5 cents. This would seem likely if they fear that, where prices are not rounded, there will be a lack of comprehension on the part of customers only buying one product. A lack of comprehension may arise e.g. where a product costs 98 cents but the customer has to pay 1 euro. However, it may also be the case that retailers will not round individual prices in order to maintain the psychological effect which they aim to achieve with prices such as 98 cents.

Inflation will not rise solely as a result of the rounding rules because final amounts will be rounded up just as much as they will be rounded down [Cf. Deutsche Bundesbank (2013): Current and projected development of coin circulation in Germany, in: Monthly Report January 2013, Vol. 65, No. 1, 29-41]. Whether there is a perceived rise in inflation – a phenomenon which is not to be underestimated since the "Teuro" debate (a pun linking the word "euro" with the German word "teuer" meaning expensive) following the introduction of the euro – depends on whether most consumers believe that rounding up and down will balance each other out. If retailers also round the individual prices, there is a risk of a one-off rise in inflation and a one-off perceived rise in inflation. A sustained rise in inflation is unlikely.

The rounding rules carry the risk of a one-off rise in inflation if retailers use the opportunity to round more prices up than down.

Whether they use this opportunity depends on the respective circumstances. If they round individual prices in order to avoid a lack of comprehension on the part of customers, fierce competition in conjunction with lower handling costs could, on the one hand, lead to prices being rounded down to the nearest five cents, particularly in the case of low-price products such as food. On the other hand, retailers may have no more scope for rounding down if the handling costs do not fall significantly and the retailers' profit margins are already small. This is when retailers may round the prices upwards. Rounding up is also more likely because retailers know if they round prices down, their competitors will follow suit in order to remain competitive. By rounding down, retailers will be reducing their profit margin without increasing their turnover. If as a result, they round up more often than down, there may be a one-off rise in inflation.

There is also the risk of a one-off perceived rise in inflation. This arises, principally, where consumers perceive price rises in relation to frequently purchased products such as food. It may even arise where retailers round their prices down just as often as they round them up because price increases, in this case due to rounding up, will be more noticeable to consumers than price reductions, in this case due to rounding down. This distorted perception may be reinforced by the fact that consumers expect the abolition of small coins to result in price increases.

A sustained increase in inflation is unlikely. Even if there is an increase or a perceived increase in inflation, consumers will see this as a one-off phenomenon caused by the abolition of small coins and will not change their inflation expectations.

Legal Assessment

Legislative Competency

The EU can harmonise the technical specifications and the denominations of all euro coins [Art. 128 (2), sentence 2 TFEU]. For the purposes of Option 2, it can therefore change the composition of the material used for small coins; and for the purposes of Options 3 and 4, abolish small coins. For this, the EU would have to amend the Regulation on denominations and technical specifications of euro coins [Regulation (EC) No. 975/98, on the new version see COM(2013) 184].

The EU does not, however, **have the competence to lay down EU-wide rounding rules** for the purposes of Options 3 and 4. It can adopt measures that are necessary for using the euro as a single currency (Art. 133 TFEU) but, although **EU-wide rounding rules** would contribute to legal certainty in cross-border payment transactions, they **are not necessary for using the euro as a single currency.** This is because national rounding rules in Finland and the Netherlands have shown that a variation in rounding rules is not noticeably detrimental to either the currency union or the internal market. The EU may only adopt a Recommendation for harmonised rounding rules (Art. 292 TFEU) since it does not require a substantive competence for this.

Subsidiarity

The principle of subsidiarity does not apply because the measures lie within the exclusive competence of the EU [Art. 3 (1) (c) TFEU].

Conclusion

Examining cost differences between mints may reduce the losses made by the euro-states on the issuance of small coins. Abolition of small coins will, on the one hand, save the time needed for payment by companies and consumers and reduce the handling costs for banks and retailers. On the other hand, the rounding rules may reduce the incentive for retailers to pass on a cost reduction to the consumer. The rounding rules also carry the risk of a one-off rise in inflation if retailers use the opportunity to round more prices up than down. The EU does not have the competence to lay down EU-wide rounding rules because they are not necessary for using the euro as a single currency.

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