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COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

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1. INTRODUCTION

The introduction of the euro in 1999 was a major step in European integration. Since 1 January 2002, the euro has been available in physical form, as banknotes and coins with now around 330 million EU citizens in 17 of the EU Member States using the euro as their currency. The denomination structure of the euro banknotes as well as of the euro coins (1, 2, 5, 10, 20, 50 cents, 1 euro and 2 euro) has remained unchanged since the introduction of the euro.

Euro coins are issued by Member States but the Council is competent for harmonizing their denominations and technical specifications. Denominations and technical specifications of euro coins intended for circulation have been laid down in Council Regulation (EC) No 975/98. In accordance with Council Regulation (EC) No 974/98, coins denominated in euro and cent and complying with the denominations and technical specifications laid down by the Council are the only coins which have the status of legal tender in all Member States whose currency is the euro.

In 2012, the European Parliament and the Council requested the competent institutions to investigate the use of different denominations of euro coins and euro banknotes against the criteria of cost and public acceptability[1].

Article 2 of the Regulation on the issuance of euro coins requires the European Commission to assess *"the continued issuance of 1 and 2 cent coins",* (…) notably via "*a cost-benefit analysis which takes into account the real production costs of those coins set against their value and benefits"*.

This mandate should be seen against the background of the debate regarding the usefulness of the two smallest euro coin denominations since their introduction. The main elements of this debate are the high production and handling costs of the 1 and 2 euro cent coins compared to their face value, the significant drop (high loss) of these coins from circulation[2], and the decrease in purchasing power of these two small denominations. The debate also centres on the issue of inflation or perceived inflation, amid the general public's fear that a potential cessation of issuance of the coins combined with a withdrawal of the coins from circulation could raise consumer prices.

[1] Recital 7 of Regulation (EU) No 651/2012 on the issuance of euro coins (OJ L 201, 27.7.2012, p. 135).

[2] The level of loss can be described by a loss rate, which is the calculation of one minus the circulation rate, whereby the latter is the number of coins returned to the central bank divided by the number of coins put into circulation.

The requested assessment was conducted on the basis of a stakeholder consultation and an extensive stock-taking exercise[3]. This communication presents four main policy options (from maintaining the status quo to withdrawal of the 1 and 2 cent coins), and highlights the options' main features as well as their pros and cons. The staff working paper, in annex, contains more detailed elements.

2. FOUR POTENTIAL SCENARIOS FOR THE 1 AND 2 EURO CENT COINS

In principle, issuance of 1 and 2 euro cent coins could either continue as now or be terminated, implying two scenarios (continued issuance and withdrawal) to be explored. However, based on the results of the questionnaires and the stock-taking exercise, four possible scenarios can be identified: continued issuance and withdrawal as the two main scenarios, with one variant scenario within each.

The first main scenario is the continued issuance of the 1 and 2 euro cent coins under today's issuance conditions without changing the legal or material context **("status quo scenario")**. The coins remain legal tender and continue to be produced in line with the current technical specifications (such as metal, weight and size) and without changing the production and issuance processes[4]. A variant of this scenario is the continued issuance at reduced costs which is based on the assumption that the coin issuance costs could be reduced by changing the material composition of the coin or by increasing the efficiency of the coin production, or both **("issuance at reduced costs scenario")**.

The second main scenario aims to abolish the 1 and 2 euro cent coins **("quick withdrawal scenario")**. Under this scenario, the issuance of these denominations would cease while the coins in circulation would be withdrawn mainly through retailers, supermarkets and banks within a pre-established short time period. Binding rounding rules would apply as of the first day of the withdrawal period and the coins would cease to be legal tender at the end of the withdrawal exercise.

A variant of the quick withdrawal scenario is a **"fading out scenario"** which would have the effect of a withdrawal but achieve it in a different way. While the issuance of coins would cease and binding rounding rules apply also under this scenario, the coins would however remain legal tender. The 1 and 2 euro cent coins could still be used, but only for payment to the rounded final sum. Because no new coins would be issued, the coins would be expected to disappear gradually from circulation due to the high loss rate and the lack of attractiveness of these coins as convenient payment means.

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3 A group of 'key stakeholders' was consulted in August and September 2012 by means of questionnaires on two main scenarios for the 1 and 2 euro cent coins: the continued issuance and a potential withdrawal of the coins. The relevant stakeholders were identified and divided into two main groups: public key stakeholders from EU Member States (i.e. national administrations, national mints, and central banks) and the ECB and private key stakeholders from European associations and business (banking associations, cash in transport business, consumer and retail associations).

4 See Article 1 of Regulation (EC) No 975/98 (OJ L 139, 11.5.1998, p. 6), as amended by Council Regulation (EC) No 423/1999.

3. TWO SCENARIOS FOR CONTINUED ISSUANCE OF THE 1 AND 2 EURO CENT COINS

3.1. Scenario of continued issuance under unchanged conditions ("status quo scenario")

This scenario is by nature the benchmark against which the three other scenarios should be assessed.

3.1.1. An ever-increasing issuance, as a consequence of a high loss rate

The number of 1 and 2 euro cent coins issued since the euro changeover in 2002 is in excess of 46 bn coins. Within ten years, the amount of these denominations increased by approximately 74%. Today, nearly one out of every two euro coins put into circulation is a 1 or 2 euro cent coin. While the overall number of issued 1 and 2 euro cent coins is very high, the total value of these coins is only about 714 m euro.

The high increase of the number of 1 and 2 euro cent coins is mainly due to the high loss rates of these denominations, which ranges from 25% up to almost 100%.

Consumers do not often use the 1 or 2 euro cent coins when paying, but receive them as change from retailers. The coins seem to be handled as non-value items and are often hoarded rather than re-circulated.

Though inflation has remained at a very low level since the launch of the euro, the purchasing power of 1 and 2 euro cent coins has already substantially eroded, declining to 0.81 euro cent on average for 1 euro cent coins.

3.1.2. A loss-making activity

The overall costs of coin issuance is hard to assess, since it includes production, packaging, transportation, storage and other distribution and re-circulation related costs for banks and retailers.

When considering coin production costs, three key components need to be investigated: (1) the costs of the raw material used for blanks (the metal token on which the coin is minted); (2) the production cost of the blanks; (3) the costs of the final production (i.e. minting) of the coins. Obtaining detailed information on the various cost elements mentioned above is not easy, since the key players involved in the production process (i.e. blank producers and mints) usually consider these elements as market-sensitive, and as such, covered by commercial secrecy.

That said, the costs of production and issuance of 1 and 2 euro cent coins are generally high. Most Member States are confronted with acquisition costs exceeding up to four times the face value of the coins themselves, leading to a negative seigniorage income. Based on the indications provided by 5 Member States, the non-weighted average acquisition price of these coins for the respective Treasuries represents around 150% of their face value, while the weighted average price is close to 300% (due to the rather high costs experienced by one large Member State).

While the replies to the questionnaire did not provide systematic detailed information on the various production cost components, some preliminary and broad indications can nevertheless be deduced:

– The costs of the coin blanks appear to amount to around 50-60% of the face value of the coin, with a relative cost generally lower for the 2 euro cent than for the 1 euro cent coins. . These high costs are due to the purchase of the raw material (metals). The coin industry has witnessed a vertical integration process, with some mints and blank producers combining forces to increase their profitability in a business that is characterized by high volumes and small margins in the blank manufacturing process.

– Preliminary findings show that the cost of the raw material constitutes only a relatively minor part of the total acquisition cost of the finished product by the national Treasuries. The substantial variations in coin production costs can therefore not be explained by the costs of the raw material or the blank production process, but should instead be attributed to the final production process of the coins (i.e. minting) that is undertaken by the national mints of the euro area.

– Further analysis would be needed to investigate whether the variation in costs among national euro area mints is caused by the differences in the labor and/or capital costs or if it is related to potential inefficiencies in the production process. The substantial cost differences between national mints can also possibly be explained by the monopolistic position of the Mints in their respective countries.

At euro area level, the (weighted) ratio between the acquisition price and the face value of coins issued would point to a total cumulated net cost of the issuance – or negative seigniorage – of 1 and 2 euro cent coins of EUR 1.4 billion euros.

3.1.3. Users are generally satisfied

In terms of public acceptance, citizens are generally in favour of continued issuance. Evidence from the Eurobarometer survey undertaken by the Commission shows that citizens are generally satisfied with the current coin denominations, with slightly less support for the 1 and 2 euro cent coins.

Mints support the continued issuance of these coins, if only because their minting represents a substantial part of their activity. Meanwhile, bank federations take a neutral view on the topic. It should be noted that both Mints and banks have the possibility to pass on the costs attached to these coins to their clients, via acquisition costs and handling fees, respectively.

The vending machine industry is not concerned by 1 and 2 euro cent coins, since vending machines do not accept these denominations. Retailers' organizations have mixed views on the question of usefulness of 1 and 2 euro cent coins, since they face high handling fees (a roll of fifty 1 cent coins can for instance sometimes carry a handling charge of 40 cents) but at the same time feel that these coins are useful for retail payment operations.

3.2. Scenario of continued issuance at reduced costs ("issuance at reduced costs scenario")

The scenario of issuance at reduced costs is a variant of the status quo scenario and entails the continued issuance of the smallest denominations, while looking into possibilities to reduce the current excessive costs of issuance. There are two ways to lower the acquisition costs of the 1 and 2 euro cent coins, not necessarily mutually exclusive: changing the coin composition and/or changing the coin production process.

3.2.1. Changing the coin composition

The first measure would be to change the composition of the coins and optimize existing manufacturing tolerances or use cheaper metal, such as stainless steel, while keeping the size of the coins unvaried. This could be achieved through an amendment of Council Regulation (EC) n°975/98.

The use of less precious metal could in some cases lead to a change of the colour of the new coins.

While views on the potential alternative compositions of the 1 and 2 euro cent coins (stainless steel, aluminium, zinc) and the size of the potential cost reductions diverge, the existence of a cost saving potential is uncontroversial.

However, as indicated earlier, the cost of the raw material constitutes only a minor part of the total costs of the finished product. The gap between acquisition costs and face value of these coins – as well as the important differences in this gap between euro area Member States - are not due to the costs of the raw material, but rather due to the production process of the coins.

3.2.2. Improving the efficiency of the production process

Further analysis would be needed to investigate whether the variation in costs among national euro area mints (with for instance one Mint being able to produce once cent coins for less than their face value and another one selling them to the Treasury four times its face value) are caused by differences in the labor and/or capital costs involved in the final coin production process or if they are related to potential inefficiencies in the production process. Addressing those possible deficiencies would fall under the responsibility of Member States.

The application of both sets of measures, while continuing the issuance of the 1 and 2 euro cent denominations could bear significant potential for savings. While the other costs of issuance (e.g. related to raw handling) would not be addressed and over-production due to a high loss rate would continue, the negative seigniorage could be significantly reduced, if not eliminated.

4. TWO SCENARIOS FOR WITHDRAWAL OF THE 1 AND 2 EURO CENT COINS

4.1. Withdrawal with quick loss of legal tender ("quick withdrawal scenario")

The second main scenario is the withdrawal of the coins with a loss of legal tender.

Under this scenario, the issuance of 1 and 2 euro cent coins would stop and the coins would almost immediately cease to be legal tender. This would require an amendment of Council Regulation (EC) n°975/98. Legally binding rounding rules (rounding to the nearest 5 cent) would probably be needed [5] and the coins would be actively withdrawn from circulation.

[5] The framework of issuance and use of 1 and 2 euro cent coins in Finland and the Netherlands is different from the situation in the other countries of the euro area. Shortly after the euro changeover, Finland reduced the issuance of 1 and 2 euro cent coins to residual amounts. The Netherlands followed this approach in September 2004. Both countries keep the level of 1 and 2 euro cent coins in circulation low due to rounding rules. In Finland, rounding rules to the nearest 5 cents are set by law for cash

4.1.1. Economic implications: positive impact on seigniorage but fear for inflation from the general public.

An important economic consideration of the withdrawal scenario is its cost-saving potential. The substantial production costs of these small coins would be eliminated and the negative seigniorage related to the issuance of the coins in most Member States would stop. Businesses, supermarkets and retailers, in particular, would no longer have to take care of cumbersome and costly handling of small denomination coins[6], the costs of which they pass on to their customers through fees or price adjustments.

Compared to the expected cost savings, stakeholders tend to believe that the one-time costs of withdrawing the coins are of secondary importance. There could even be a positive impact on state income, given the potential elimination of the afore-mentioned costs of production. Furthermore, the abolition of the two lowest denominations could slightly increase the demand for 5 and probably 10 euro cent coins, with an expected positive impact on seigniorage.

On the other hand, a key public concern is that the quick withdrawal scenario would increase inflation. It is feared that the abolition of the 1 and 2 euro cent coins could lead to price increases, despite the application of rounding rules. The rounding of final sums or individual prices might lead consumers to also expect upward rounding or outright price increases in the future. This concern particularly holds if the rounding affects items that are frequently purchased and typically paid in cash and could thereby influence inflation expectations. However, a withdrawal is not expected to have a significant impact on price stability for a number of reasons:

– First, a number of studies have demonstrated that the inflationary effects, if any, would be very limited. In Slovakia, for example, a study on inflationary impacts of the withdrawal of 10 and 20 Haller coins concluded that the cessation and related rounding rules would have only limited inflationary impact, with effects of less than 0.01%.

– Second, first-hand experience with rounding rules in Finland and the Netherlands has shown that the impact of inflation was minimal or non-existing.

– Third, rounding rules would apply only to the final transaction and not to individual prices, thus limiting the potential impact.

While such a withdrawal is not expected to have a noticeable impact on inflation, experience with the euro cash changeover shows however that it could contribute to a distortion of inflation perceptions (with a perception of a price increase not matched by HICP data) and as such, lead to some citizen discontent. Many stakeholders emphasized, during the consultation process, that citizens are currently very sensitive to plans and initiatives which could be perceived as affecting their financial situation, particularly because of the difficult general economic environment. If such a scenario were implemented it would, therefore, have to be

payment, whereas similar rules are implemented in the Netherlands since September 2004 on the basis of an agreement between the retail sector and consumer associations.

[6] Both aspects were the main drivers of the recent abolition of the lowest denominations in Sweden in 2010 (50 øre coin = around 5,5 euro cent) and Canada in 2013 (1 cent coin = around 0,7 euro cent).

accompanied by an intensive campaign to inform the public on the practicalities of the coin withdrawal and the rounding rules to be applied.

4.1.2. Citizens' and Member States' view on a withdrawal of low denomination coins

The Eurobarometer survey conducted by the Commission shows that citizens seem to be satisfied with the euro coin denominations in general. The minority of citizens dissatisfied with the present coin denomination structure generally express a wish to have the 1 and 2 euro cents coins withdrawn.

When asked for their preferred choice between continued issuance and withdrawal of 1 and 2 euro cent coins in the formal consultation, the majority of Member States did not provide any answer to this question while a small number s opted for withdrawal. No firm conclusions can be drawn on the basis of this partial result.

4.2. Withdrawal through fading out period

The fading out scenario would have the same effect as a withdrawal, but achieve it through a a common decision of the Member States to stop issuing 1 and 2 euro cent coins, combined with the application of rounding rules. These coins would remain in circulation as legal tender but, would progressively disappear, as a joint consequence of the high loss rate and the absence of new issuance. The legal tender of the coins would be withdrawn when their circulation becomes purely residual.

4.2.1. Rounding rules would be needed

Rounding rules would probably need to be introduced to compensate the increasing shortage of 1 and 2 cent coins, while not preventing their use (these coins could still be added to reach 5 cents, like in Finland or the Netherlands). An information campaign would be needed to explain both the fading out and the rounding rules.

4.2.2. Circulation could become residual within a few years

The exact rhythm of the operation cannot be predicted accurately, since there is no empirical data on fading out scenarios from Member States or other countries.

The calculation below simulates the effects of a fading out based on the average loss rate (around 60%), assuming it remains stable over time. Most coins would stop circulating within a 4-5 years horizon. Their circulation would become purely residual around 2020, at which point a decision to witdraw their legal tender could be made.

1 cent coins **Annual loss rate 60%**								**2 cent coins** **Annual loss rate 60%**						
2013	2015	2017	2019	2021	2023	2025		2013	2015	2017	2019	2021	2023	2025
26,260	4,202	672	108	17	3	0		20,606	3,297	528	84	14	2	0

Though the circulation of coins would diminish quickly under this scenario, banks, supermarkets and other retailers would continue to face costs for handling the remaining coins. However, no active withdrawal effort would be required.

5. CONCLUSIONS

Based on the results of the stakeholder consultation and the above analysis, a number of key conclusions can be drawn with regard to the continued issuance of 1 and 2 euro cent coin.

- The production of 1 and 2 euro cent coins is clearly a significantly loss making activity for the euro area. Each of the four scenarios for addressing these problems could apply to the 1 and 2 euro cent coins even-handedly. The analysis did not bring up any indication that the scenarios should apply to one denomination instead of the other (i.e., 1 or 2 coin) only.

- The attitude of the general public to 1 and 2 euro cent coins is paradoxical: they seem attached to these small denominations and fear the risk of inflation if they were to disappear, but they handle these coins as non-value items and do not re-circulate them in payment channels. The resulting high loss rate combined with the existence of psychological prices lead to an ever-growing demand for issuance of new small coins.

- The economics of issuing 1 and 2 euro cent coins would plead for discontinuing issuance. That said, cost elements need to be balanced against other considerations, notably the negative reaction from the general public that rounding rules could trigger. They should also in particular be balanced against the background of the current depressed economic outlook.

- Discussions between stakeholders are needed on the basis of the above described four scenarios. Should a clear preference emerge, the Commission will come forward with the necessary legislative proposals.