10th September 1991

Confidential

Final

MINUTES

OF THE 257th MEETING OF THE COMMITTEE OF GOVERNORS

OF THE CENTRAL BANKS OF THE MEMBER STATES

OF THE EUROPEAN ECONOMIC COMMUNITY

HELD IN BASLE ON TUESDAY, 9th JULY 1991 AT 10.30 a.m.

Table of contents

Preliminary remarks

On behalf of the members of the Committee, the Chairman wished to record the deep sense of loss felt by all at the untimely death of Mr. Huib Muller of De Nederlandsche Bank. He had been a gifted man who had gained a significant reputation as Chairman of the Basle Committee on Banking Supervision. His professional manner had earned him many friends and considerable respect. Mr. Duisenberg was asked to convey the Committee's sentiments to his colleagues at De Nederlandsche Bank.

I. Approval of the minutes of the 256th meeting

The Committee approved the minutes of the 256th meeting.

II. Monitoring of economic and monetary developments and policies in the EEC based on:

- Preparation by the Foreign Exchange Policy Sub-Committee (Monitoring);
- Statistical charts and tables.

1. Statement by Mr. Dalgaard, Chairman, Foreign Exchange Policy Sub-Committee (Monitoring)

The Monitoring Group had concentrated on the performance of the US dollar and, in particular, the question of whether the dollar had strengthened too much and, if so, whether action was required.

The US dollar had firmed by 5% against the ecu since the Governors' last meeting and by 20% since the end of the Gulf war. The US authorities had not appeared to be overly concerned at the dollar's appreciation since stronger US growth had been expected and inflation was said to be under control. It had been felt that interventions alone would not change market sentiment fundamentally, especially without the support of the Federal Reserve, which did not appear to be willing to intervene at present exchange rate levels.

To maintain price stability the Deutsche Bundesbank had wished to see a stronger Deutsche Mark, but other European central banks had been less eager to stem the dollar's rise, since the prevailing exchange rate levels had enabled European companies to regain some competitiveness. A further rise, however, could lead to an increase in inflation and might result in higher world interest rates, which in turn would not help the recovery of the world economy. The terms of the recent foreign exchange agreement between the Deutsche Bundesbank and the Federal Reserve had been discussed briefly.

In the ERM, tensions between the peseta and French franc had eased around mid-June as a result of the peseta weakening by 1% against the ecu in connection with market rumours that the peseta would be brought within the narrow fluctuation band. Since then, the ERM had remained free of pressure. The French franc had strengthened and the Danish krone had weakened a little, thereby becoming the weakest currency in the narrow band.

The economic situation in Germany had been reviewed briefly. It had been noted that the recent rise in long-term interest rates had been linked to a ruling by the German Federal Constitutional Court regarding equal tax treatment of interest income.

Outside the ERM, the reasons for restrictions on the ability of Portuguese non-residents to purchase floating rate securities had been discussed.

2. Statement by Mr. Rey, Chairman, Committee of Alternates

The Alternates had questioned whether the recent rise of the US dollar had been in accordance with the fundamentals, given the recent evidence of weak export performance and the prospects of a widening of the US current-account deficit. Some concern had also been expressed about the effects of the rise of the US dollar on price stability outside the United States. In the event of new upward pressure, appropriate signals might have to be given to the markets to restore more stable expectations. This had raised the issue of the conditions required for co-ordinated intervention; one such condition would be the active participation of all central banks, including the US authorities. Some doubted whether the required result could be achieved without major policy changes being undertaken by the US Authorities in support of such action.

The imposition of controls on capital inflows in Portugal had been discussed briefly, as had recent economic developments in the United Kingdom and Germany.

3. Discussion by the Committee

Mr. Tavares Moreira said that the imposition of restrictions on capital inflows, of which he had informed the Committee of Governors on 5th July, had been undertaken in accordance with Portugal's derogation clause, which afforded the possibility of maintaining or reintroducing such capital controls until the end of 1992. The Portuguese authorities' action had been taken after informal consultations with the EC Commission. The controls would not affect foreign investment and had been aimed at curbing heavy speculative capital inflows.

III. Adoption of the Committee's report to the EEC Ministers of Finance on developments on the foreign exchange markets of the nineteen countries participating in the concertation procedure during June and the first few days of July 1991

The Committee adopted the report, which would be sent to the EEC Ministers of Finance in the usual way.

IV. Narrowing of ERM fluctuation margins

1. Statement by Mr. Dalgaard, Chairman, Foreign Exchange Policy Sub-Committee

Mr. Dalgaard introduced the Sub-Committee's report on the narrowing of ERM fluctuation margins and outlined the advantages and drawbacks of narrowing the fluctuation margins and the consequent effects on the credibility of the EMS. Increased credibility associated with the narrowing of the margins would only materialise in circumstances where there was a high degree of convergence and an appropriate institutional framework. On the whole, it had been felt that it would be very difficult to quantify the effects of narrowing the margins, although there were no insurmountable technical difficulties.

2. Statement by Mr. Rey, Chairman, Committee of Alternates

The Alternates had endorsed the contents and conclusions of the report, although one Alternate had felt that it had been excessively critical of a proposal which should not be judged solely on technical grounds but also on its political merits. It had been suggested that the report should remain an internal document and not be sent to the political authorities; instead, the thrust of the report should be conveyed to the Ministers in the form of a short statement by the Chairman of the Committee of Governors on the occasion of the next informal ECOFIN meeting on 21st September 1991.

3. Discussion by the Committee

Mr. Hoffmeyer said that he felt that the report had been slightly unbalanced; it was apparent to all that such an obligation would obviously restrict the authorities' freedom for manoeuvre. Nevertheless, the report had made it very clear that it was a political choice and it had confirmed that there were no technical difficulties to narrowing the margins.

Mr. de Larosière said that he welcomed the report but that great care should be taken when putting the Governors' view to the Ministers of Finance. He felt that the creation of a timetable for such a move could prove counter-productive. Some flexibility had to be left in the System since there remained a number of elements which could jeopardise the smooth operation of the ERM. The greater the degree of convergence, the more critical was the margin for manoeuvre within the ERM.

Mr. Ciampi said that the report should not be transmitted to the Ministers because, as it had correctly stated, there were many issues which had to be taken into consideration beyond those of a purely technical nature, the foremost being convergence and the establishment of an institutional mechanism for improving the co-ordination of monetary policy.

V. Examination of the report on recent developments in public finance and policy implications

1. Statement by Mr. Raymond, Chairman, Monetary Policy Sub-Committee

Mr. Raymond summarised briefly the conclusions of the report, which had shown in 1990 a break in the relatively favourable economic development that had occurred between 1986 and 1989, when the aggregate budget deficit of the Community had tended to shrink. However, the benefits of strong growth experienced in that period had not been fully exploited to reduce the size of the public debt; thus in 1990, when economic activity had slowed, there had been a Community-wide deterioration in the state of public finances. Mr. Raymond also described those countries where the financial situation had worsened and commented on the special situation in Germany and the implementation of structural measures in Greece. For the Community as a whole, public debt as a percentage of GNP had not changed in the financial year 1990; thus the declining trend experienced between 1987 and 1989 had not continued, although trends in the various Member States had been far from uniform. A positive aspect had been that the financing of the debt had improved, with Member States turning almost exclusively to domestic financial markets; on average, the maturity of the debt had lengthened. Convergence in the public sector had on average improved; there had of course been exceptions, amongst which were Germany and Italy.

2. Statement by Mr. Rey, Chairman, Committee of Alternates

The Alternates had discussed the excellent report by the Sub-Committee and had concluded that the overall picture had been a source of deep concern. Moreover, it had been noted that the latest estimates on budget deficits in some countries showed that the outcome for 1991 could be worse than had been estimated in the report. In the light of these disquieting developments, and given the limited impact of repeated warnings expressed by the Governors on previous occasions, the Alternates had suggested that the transmission of the report should be linked to the informal ECOFIN meeting in September. In the meantime the report would be updated and a statement by the Chairman prepared which would explain the reasons why monetary authorities were concerned at recent developments in public finance.

3. Discussion by the Committee

Mr. Chalikias said that recent monetary developments in Greece had been in line with the targets. The growth of credit to both the public and private sectors had continued to decelerate. With regard to budgetary adjustments, however, it would appear that the Government would fall short of its fiscal deficit target. Describing recent developments in the public sector, Mr. Chalikias noted that there had been inadequate progress in combating the country's widespread tax evasion.

Mr. Christophersen said that there was a risk that the Community's targets for the balance-of-payments loan to Greece would not be met. Fiscal policy had not met the terms of the agreement and, as a result, the Commission would present a critical report to the Monetary Committee the following day. Unless the terms of the Community's loan agreement were satisfied, it might not be possible to disburse the second tranche of the loan and this would severely damage the credibility of the stabilisation programme. He hoped that the central bank representatives would contribute to the debate in the Monetary Committee.

Mr. Leigh-Pemberton said that he welcomed the Alternates' proposal for improving the potency of the presentation of the public finance report to the Ministers of Finance. With respect to the United Kingdom, he felt that the automatic stabilisers should be permitted to function provided that they did not cloak an underlying deterioration in public sector finances. The budget deficit had risen: in view of the particularly sharp economic recession, it had been considered reasonable to allow public expenditure to increase; however, the debt/GDP ratio was low and had continued to fall. The automatic stabilisers were working and their effects would be counteracted in the medium term when the budget moved back to a balanced position.

Mr. Duisenberg said that he also supported the Alternates' proposal. It had become increasingly difficult to judge the nature of deficits, since there had been a growing tendency by governments to place certain expenditure outside budgets. If the Committee of Governors had to form a regular opinion on public finance, the nature of these deficits should be clear and unambiguous. He suggested that the Economic Unit, in conjunction with the Monetary Policy Sub-Committee, should establish a harmonised approach to analysing the nature of government deficits.

Mr. de Larosière also supported the Alternates' proposal. The Ministers should be advised that the deterioration of the budgetary positions of the Member States observed in 1990 and 1991 had been a worrisome development which tended to impair the quality of the policy mix and overburden monetary policy. The use of automatic stabilisers could under certain circumstances be legitimate, but it would not be the correct solution in countries which had large imbalances together with a significant public debt in relation to GDP and savings. It was necessary to remind the Ministers that the general improvement in economic growth over the recent years had not been used to ameliorate the deteriorating fiscal positions of the Community's economies. If Ministers required more palatable monetary policy conditions they should first of all consolidate their budgetary positions.

The Chairman described his concerns in respect of the deterioration of the fiscal position in Germany and summarised briefly the economic situation. He fully agreed that it was essential for the Ministers' attention to focus on the monetary consequences of fiscal policy, especially in relation to its effect on partner countries and the overall stability of the ERM.

Mr. Hoffmeyer said that it was possible to offset automatic stabilisers if tensions existed in other areas. Should unemployment increase substantially, however, there would be strong political reluctance to neutralise all automatic stabilisers. He agreed that an understanding should be reached with the Finance Ministers and that this should be co-ordinated with the medium-term programme.

Mr. Christophersen distributed to the Committee the Conclusions of the ECOFIN meeting of 8th July 1991. He hoped that the central bank Governors, through their representatives on the Monetary Committee, would contribute to the discussion on medium-term adjustment programmes which would be undertaken on a regular basis. As provided for in the Council Decision on multilateral surveillance and macro-economic co-ordination, there would be a possibility for the ECOFIN Council to adopt policy recommendations for individual Member States. He welcomed the suggestion that the Chairman of the Committee of Governors should comment on the monetary policy consequences of the fiscal stance in Community countries at the forthcoming informal ECOFIN meeting on 21st September 1991.

Mr. de Larosière said that the document circulated by the Commission painted a very telling picture. He agreed that the Chairman of the Committee should convey to the Ministers of Finance the sentiment of the Committee concerning the monetary consequences of fiscal developments within the Community.

VI. Implementation of measures proposed by the Economic Unit with a view to harmonising monetary aggregates

1. Statement by Mr. Raymond, Chairman, Monetary Policy Sub-Committee

Mr. Raymond assessed briefly the conclusions of the Monetary Policy Sub-Committee following its examination of the Economic Unit's fifteen proposals for the reform of broad monetary aggregates. All Member States had indicated that they would be prepared to supply the Secretariat with statistics in accordance with the proposals. Where precise figures were not available estimates would be provided. Specifically, Denmark, Greece, Spain, Ireland, Italy, Luxembourg and Portugal had expressed their willingness to introduce the proposed changes in official broad aggregates, although not all of these countries would be able to implement the changes by 1992 owing to the lack of available data. In some countries, such as Germany and France, the proposals were still under review. The United Kingdom remained sceptical about the use of such aggregates when defining annual targets and would not wish to alter its official aggregate in accordance with the recommendations.

In the course of discussion a number of problems had not been solved. No decision had been reached with regard to data collection and the treatment of mutual funds (UCITS). There was no general agreement as to whether Treasury bills should be included in aggregates. A further pending issue had related to the treatment of residents' deposits held abroad.

2. Statement by Mr. Rey, Chairman, Committee of Alternates

The Alternates had commended the work and welcomed the progress made by the Economic Unit and the Monetary Policy Sub-Committee in the area of aggregates. The recommendation for the central banks to provide the necessary information had been endorsed. It had been noted that the majority of countries were ready to implement the proposed changes in their official aggregates next year and that these changes should be announced at national level with a reference to the ongoing process of harmonisation in monetary statistics promoted by the Committee of Governors. Publicity in the form of a collective statement of some kind by the Committee of Governors could be considered in the context of the forthcoming ex-ante exercise. The Alternates had recommended that the Committee of Governors express its strong desire for further progress towards a common system of monetary statistics at Community level. In this context, Community central banks should consider how to integrate into the relevant aggregate the available BIS data on cross-border liabilities of EC reporting banks. The EC Secretariat should therefore be permitted direct access to the data reported by EC central banks to the BIS, and it had been recommended that any such request should be met with a favourable response.

3. Discussion by the Committee

Mr. Duisenberg said that he warmly welcomed the proposals of the Economic Unit and the Monetary Policy Sub-Committee. However, De Nederlandsche Bank would be willing to use M_3 instead of M_2 as its official aggregate on the understanding that it would include short-term government liabilities, which De Nederlandsche Bank regarded as close substitutes for the monetary liabilities of banks. Although presently they were small, the exclusion of Treasury bills in the harmonised definition might be taken as a signal that the short-term financing of government deficits was no longer relevant to monetary policy and could heighten the use of such instruments by governments to finance the government debt outside the money stock. However, De Nederlandsche Bank would accept the exclusion of short-term liabilities from M_3 if it were agreed that alongside the harmonised M_3 there would be a broader harmonised aggregate, say M_4, which would include short-term government liabilities and, possibly, short-term commercial paper.

Mr. de Larosière and Mr. Rubio supported Mr. Duisenberg.

Mr. Raymond said that the whole question of the inclusion of Treasury bills in aggregates was an extremely complex issue and one which had been discussed by the Sub-Committee. For instance, the inclusion of such instruments would be appropriate if there was an active short-term secondary market. Furthermore, should a government change its funding policy, i.e. by restructuring the maturity of the public debt, a problem could arise regarding the interpretation of the aggregate.

Mr. Ciampi said that the inclusion of Treasury bills could reduce the stability and therefore value of the proposed monetary aggregate. With regard to the other paper of the Economic Unit on the "Usefulness of the Money Supply and its Counterparts in the Assessment of Monetary Policy", he said that he was somewhat surprised to see that it had been based on an extreme asymmetric assumption that only one currency plays the role of anchor. This latter view was also supported by Mr. de Larosière.

With respect to Mr. Ciampi's comments on the Economic Unit's paper on counterparts, Mr. Baer said that the reference to a single anchor currency had been purely a working assumption. The paper did not specifically deal with the asymmetry of the EMS but with the question of counterparts and their usefulness in monetary policy co-ordination. The paper's conclusion had not been affected by the assumption concerning an anchor currency.

The Chairman said the proposals of the Economic Unit, the Sub-Committee and the Committee of Alternates had been supported and that the Economic Unit should prepare a further paper on issues concerning the inclusion of short-term Treasury bills and commercial paper in monetary aggregates. It was agreed that the announcement of the proposed changes at national level would include a reference to an ongoing process of harmonisation in monetary aggregates which had been promoted by the Committee of Governors. The issue of more additional publicity would be examined by the Committee in the context of the next ex-ante exercise.

VII. Economic and Monetary Union

1. Statement by Mr. Rey, Chairman, Committee of Alternates

The Alternates had reviewed the amendments introduced by the IGC to the draft Statute of the ESCB as proposed by the Committee of Governors. The procedure by which the Committee of Governors might convey its remarks to the IGC had also been discussed.

In this context, the Alternates had considered that the Governors' reaction should take the form of a letter which the Chairman would send to the President of the IGC. The draft would be prepared by the Secretariat, reviewed by the Alternates and submitted to the full Committee for its consideration.

The Alternates had noted that the draft Statute had been well received by the IGC and that, on the whole, the amendments had not threatened its cohesion. Where deviations from the original draft proved to be a source of concern, it would be important to reiterate the reasons why the Governors had preferred the text as originally drafted. The Committee of Governors should avoid any confrontation with the IGC. In selecting those amendments which were worthy of comment, the Alternates had been guided by two criteria: firstly, the deviations should be of major concern and, secondly, they should be restricted to provisions on which there had been unanimous agreement among the Governors. This second criterion had not been accepted by all; some Alternates had considered that it would also be of value to restate the majority view or, at least, that a further attempt should be made to reach a unanimous position in the Committee of Governors.

The principal areas of concern had been:

- the involvement of the System in supervisory tasks: the Banking Supervisory Sub-Committee had informed the Committee of Alternates that it had unanimously agreed that the provisions of the draft Statute concerning banking supervision as transmitted by the Governors in November 1990 should be retained. The Alternates had endorsed this view;
- the term of office of the members of the Executive Board;
- the scope of any secondary Community legislation to be adopted in connection with minimum reserves: this should be clearly circumscribed;
- the avoidance of monetary financing of the public sector: the Alternates, with one exception, had favoured the formulation as presented in Article 21.1 of the original draft;
- financial provisions:
  - the identity of the shareholders of the ECB;
  - making increases in the ECB's capital subject to complementary Community legislation, particularly the provision which would impede the automatic offsetting of possible shortfalls;
  - restrictions on the transfer of net profits by the ECB to its reserves;

- limitations on the amount of foreign exchange reserves that could be transferred to the ECB, and especially the provision that amendments to the proposed ceiling would be subject to a unanimous decision by the Council of Ministers;
- the possibility of moving away from objective to political criteria for establishing the key which would determine the subscription of the ECB's capital and the distribution of income and the weighting of votes.

The Alternates had also considered Article 109B of the draft Treaty regarding an Economic and Financial Committee which would replace the present Monetary Committee. The inclusion of representatives of the ESCB as full member of this Committee would raise problems. To the extent that additional contact between the ESCB and the political authorities was needed, it had been felt that a more appropriate arrangement should be found. One suggestion would be for the representatives of the ESCB, at staff level, to be invited to attend meetings of the new Committee; another method would be to develop some form of informal contact between Treasury and central bank officials, as was the current practice in many countries.

In addition, some Alternates had felt that the Committee of Governors should also comment on those provisions for which the Governors had initially proposed alternative texts and where the wording on the Presidency's non-paper did not reflect the opinion of the majority of the central banks. These related namely to the distribution of responsibilities between the Council of the ECB and the Executive Board, the division of tasks between the ECB and the national central banks and the question of whether lending by the ECB and national central banks should always be set against adequate collateral. The majority of Alternates had concluded that on these points the central banks should bilaterally brief their national representatives at the IGC.

The Alternates had also a first discussion on the transitional provisions relating to Stage Two. It had not been possible to reach a meaningful consensus largely because of divergent interpretations of the Rome communiqué. The matter would be kept under review and the Alternates would meet early in September to review the situation.

2. Discussion by the Committee

Mr. Christophersen said that the Dutch Presidency had intended to hold four IGC meetings. He outlined briefly the agenda for the next few meetings. In the discussion on 8th July 1991 progress had been made concerning the arrangements for transition from Stage One to Stage Two. At the meeting on 9th September 1991 the criteria for transition to Stage Three would be the principal discussion item. The IGC on EMU had been progressing satisfactorily but the Conference on Political Union had not developed quite so well. He remarked that the work undertaken by the Committee had been positively received by the IGC.

Mr. Leigh-Pemberton said that the Committee of Governors had a problem with regard to timing, especially with the IGC meeting on 9th September 1991. The question was how best to respond to the amendments tabled by the IGC. He suggested that the Chairman should write to the President of the IGC setting out the observations of the Committee and that the individual members of the Committee should lobby their national representatives at the IGC.

Mr. de Larosière fully supported this view. The letter should, firstly, address the major concerns as outlined by Mr. Rey, and, secondly, make reference to the distribution of power between the Council and the Executive Board and the formulation of the principle of subsidiarity. The aim would be simply to recall the various opinions that existed among the members of the Committee of Governors. This would re-emphasise the thoroughness of the discussion on the points in question.

The Chairman agreed with these views. He asked Mr. Rey and the Secretariat to prepare a letter along the lines suggested. He thought that it would not be appropriate to use the terms "minority" or "majority" opinions in the second section of the letter. The letter would be circulated to the members of Committee of Governors for comment prior to signature by the Chairman. Members should also discuss the issues bilaterally with national representatives at the IGC.

VIII. Other matters falling with the competence of the Committee

Mr. Hoffmeyer said that, further to his speech the previous night and on behalf of the Committee members, he wished to congratulate Mr. Pöhl on his lasting impact and immense contribution as a member as well as the Chairman of the Committee of Governors and thanked him for his commitment to the work done in respect of the harmonisation of monetary aggregates and for taking the initiative with regard to the draft Statutes of the ESCB and ECB.

The Chairman thanked Mr. Hoffmeyer's for his kind words and took the opportunity also to repeat his thanks to the Committee. He also thanked the outgoing Chairmen of the Monetary Policy and Foreign Exchange Sub-Committees, Mr. Raymond and Mr. Dalgaard, for their enormous and valuable contributions over the years, the importance of which was evidenced by the fact that the expert groups had become the supporting pillars for much of the work of the Committee of Governors. He offered his congratulations to Mr. Borges and Mr. Saccomanni, who were to become the new chairmen of the respective Sub-Committees.

IX. Date and place of next meeting

The next meeting would take place in Basle on Tuesday, 10th September 1991 at 9.30 a.m.

257th MEETING OF THE COMMITTEE OF GOVERNORS

9th JULY 1991

Those present were:

Chairman of the Committee of Governors	Mr. Pöhl
Banque Nationale de Belgique	Mr. Verplaetse Mr. Rey* Mr. Michielsen
Danmarks Nationalbank	Mr. Hoffmeyer Mrs. Andersen
Deutsche Bundesbank	Mr. Tietmeyer
Bank of Greece	Mr. Chalikias Mr. Papademos
Banco de España	Mr. Rubio Mr. Linde Mr. Durán
Banque de France	Mr. de Larosière Mr. Lagayette Mr. Cappanera
Central Bank of Ireland	Mr. Doyle Mr. Coffey Mr. Reynolds
Banca d'Italia	Mr. Ciampi Mr. Dini Mr. Santini
Institut Monétaire Luxembourgeois	Mr. Guill
Nederlandsche Bank	Mr. Duisenberg Mr. Szász
Banco de Portugal	Mr. Tavares Moreira Mr. Borges Mr. Carvalho
Bank of England	Mr. Leigh-Pemberton Mr. Crockett Mr. Foot
Commission of the European Communities	Mr. Christophersen Mr. Pons
Chairman of the Foreign Exchange Sub-Committee	Mr. Dalgaard
Chairman of the Monetary Policy Sub-Committee	Mr. Raymond
Secretariat of the Committee of Governors	Mr. Baer Mr. Giles Mr. Strauss-Kahn

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* Chairman of the Committee of Alternates