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FINAL

MINUTES
OF THE 276TH MEETING OF THE COMMITTEE OF GOVERNORS OF THE CENTRAL BANKS OF THE MEMBER STATES OF THE EUROPEAN ECONOMIC COMMUNITY

HELD IN BASLE ON TUESDAY, 11TH MAY 1993

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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 April 1993 and the first few days of May 1993

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

IV ECU Clearing and settlement system

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

The Alternates had taken note of the progress made by the ECU Banking Association (EBA) in improving the safety features of the ECU Clearing as set out in the report by the Working Group on EC Payment Systems entitled "Implementation by the ECU Banking Association of short-term measures to improve the ECU Clearing".

With regard to the oversight of the ECU Clearing, it had been noted in paragraph 37 of the report that the EBA intended to make provisions for informing the relevant central bank whenever an individual bank regularly or systematically exceeded its limits, although it was also stated that there was no unanimity in the Working Group as to the consequences to be drawn by central banks from such advice. In this connection, the German Alternate had stressed that central banks should not be obliged to resolve problems arising from the functioning of the ECU Clearing. Furthermore, paragraph 38 stated that the home central bank of non-EC ECU Clearing banks would need to be involved in the oversight process; the wish had been expressed that the concertation with these central banks should involve the central bank of the host EC country in which these banks operated.

2. Discussion by the Committee

The ***Chairman*** expressed his gratitude to the Working Group and to the ECU Task Force for the work they had undertaken to date and for the considerable progress which the EBA had made with regard to risk reduction in ECU payments. Mr. Padoa-Schioppa, the Working Group's chairman, had taken the initiative to request the ECU Task Force to examine the extent to which those shortcomings, which would remain in the clearing system after the introduction of the short-term measures that had been announced, might be eliminated. It also needed to be examined whether the introduction of a common central bank liquidity facility might contribute to assuring the clearing and settlement of ECU payments transactions under all circumstances; the German reservation in this regard had been noted.

Mr. Schlesinger said that the German authorities considered the ECU as a private innovation; as such it was the commercial banks, not the central banks, which were responsible for it.

Mr. de Larosière said that the Committee should continue to encourage the EBA to introduce as soon as possible measures that would enable the minimum standards contained in the Lamfalussy report to be met. Progress had been made but more had to be done, in particular with regard to the real-time control of intraday positions. Consideration should also be given to how the ECU Clearing System would integrate with the future payment systems that were being constructed in the Community.

The ***Committee*** took note of the Working Group's report.

V Preparatory work for the move to Stages Two and Three of EMU

(a) Operational and ECU-related functions of the EMI

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

In accordance with its special mandate, the Foreign Exchange Policy Sub-Committee had reviewed the issues connected with the performance by the EMI of the operational functions and ECU-related tasks envisaged in the Treaty and in the Statute of the EMI. The Sub-Committee's report was an interim one since further guidance was needed from the Governors before it could proceed with a detailed analysis of all of the technical and logistical implications of the options identified. The report reflected the different views expressed by the Sub-Committee members and no attempt had been made at this stage to arrive at compromise solutions.

With regard to the operational functions of the EMI, the following issues had emerged. A large majority of the Sub-Committee members had considered that the EMI should perform the functions of the EMCF in exactly the same way as they were currently carried out. One central bank had suggested that the EMI should be empowered to hold and manage directly the gold and US dollar reserves swapped against official ECUs. Such functions could be gradually taken over from national central banks during the course of Stage Two. On the question of the reserve management function, a number of questions had been raised. Firstly, whether the EMI should be allowed to manage only reserves denominated in non-Community currencies, such as US dollars and yen in order to avoid any interference with national monetary policy, or whether it could also be allowed to manage reserves denominated in Community currencies subject to the same rules which applied to EMS central banks. A majority of the Sub-Committee members had been in favour of the latter option. Secondly, there had been broad agreement that the EMI should not be considered the owner of the reserves entrusted to it; these would therefore not appear on the EMI's balance sheet (the off-balance sheet option). While there had been unanimous support in the Sub-Committee for the off-balance sheet option for the management of securities holdings, one central bank had considered it possible for the EMI to take deposits on the basis of an on-balance sheet option. Thirdly, most members had supported the view that a management fee should be levied on national central banks which made use of the EMI's services, while some members had suggested that the cost of the reserve management function should be covered by the EMI's general budget. A further option envisaged a fee being levied based on current market rates with possible excess costs covered by the general budget. With regard to the management of the EMI's own resources, the Sub-Committee had focused on the implementation of the transitional arrangements agreed upon by the Committee of Governors last February: either the EMI would entrust one or more central banks, or the BIS, to manage the contributions it received; or it would call in gradually the funds needed to meet its current expenses.

The performance of the EMI's ECU-related tasks had been a less controversial area. The following points had been made. Firstly, with regard to the oversight of the development of the ECU, there had been broad agreement that the EMI should review private ECU developments on an annual basis, possibly supplemented by more frequent studies of specific issues. Secondly, concerning the

the EMI might not be taken before the autumn following which a number of logistical measures would need to be taken.

Mr. Christophersen said that the utmost should be done to ensure that the EMI started on 1st January 1994. It would be a poor signal if delays were to be anticipated at this stage. He added that he was due to have a meeting with the Belgian Finance Minister that week to discuss the work programme for the ECOFIN Council in the second half of the current year and would try to establish a reasonable timetable for the necessary legislative measures that had to be taken.

Mr. de Larosière supported Mr. Christophersen's remarks. Although the timetable was getting tight, the principle should be maintained that the EMI was going to start on 1st January 1994. It was important not to give the impression that the creation of the EMI would be postponed.

Mr. Leigh-Pemberton agreed that the policy-makers should continue to operate on the basis that the EMI would come into effect on 1st January 1994, otherwise the progress that was now being made could be impeded. With regard to the ratification process in the United Kingdom, it seemed likely that the necessary procedures in the House of Commons would be completed around the middle of May; despite possible delays in the House of Lords, the entire parliamentary process might be completed by the end of July. The exclusion of the social protocol from UK legislation would not appear to affect the ability of the British Government to ratify the Treaty in its entirety. However, certain members of the House of Commons had applied to the courts to get a ruling on whether this was in fact possible; it was conceivable that the courts might not deliver a ruling on the matter until October.

Mr. Schlesinger said that the timing and outcome of the case which was before the Constitutional Court in Germany in respect of whether the Maastricht Treaty conformed with the German constitution was currently uncertain.

The ***Chairman*** recalled that the Committee of Governors would have to be consulted by the Council on legislation concerning the key for financing the EMI (Article 16 of the Statute) and the consultations between the Member States and the EMI (Article 109f(6) of the Treaty in conjunction with Article 109f(8) of the Treaty). He asked Mr. Christophersen whether it was the Commission's intention to involve the Committee in the preparatory work on the draft legislation.

Mr. de Larosière queried the distinction drawn by Mr. Christophersen between those pieces of legislation to be completed before the EMI was established, which he had described as having a monetary character, i.e. the key to the financing of the EMI and the consultation procedures between the EMI and the authorities of the Member States, and those of a non-monetary nature which covered the excessive deficit procedures, the question of privileged access to financial markets and the financing by central banks of public sector deficits. It was his understanding that national legislation would have to conform to the relevant Community laws before 1st January 1994 as was being done in France in respect of central bank financing of the public sector.

Mr. Christophersen said that he had made the distinction on the basis of which areas of legislation were initially absolutely necessary. He added that the Commission would send the Governors a letter setting out its proposals for the key to the financing of the EMI and on the consultation procedures to be established between the EMI and the relevant national authorities.

Mr. Rey recalled that the Governors had expressed their opinion on central bank financing of the public sector in a letter to the President of the Commission dated 20th April 1993. Mention had also been of the need for an ongoing oversight procedure of central bank practices in respect of questions such as the financing of existing public sector debt after the EMI had been established.

VI Other matters falling within the competence of the Committee

(a) Development of the Committee's expenses in the first quarter of 1993

Mr. Doyle said that the Committee on Financial Matters had examined the first quarter's expenses. The statement prepared by the Secretariat showed that expenses had been below the projected figure because: firstly, the filling of vacancies in the Secretariat had occurred later than anticipated or had yet to be done; secondly, fewer meetings had taken place than had been scheduled, which meant that operating expenses were lower than projected; and thirdly, invoices for technical equipment that had been bought had not yet been received.

The *Committee* took note of Mr. Doyle's report.

(b) Denomination of very short-term financing balances

The *Chairman* said that in the Committee's report to the Finance Ministers on the implications and lessons to be drawn from the recent exchange rate crisis, it was stated that the "Committee intends to study various possibilities of changing the present arrangements with respect to the denomination of the very short-term financing balances". The proposals which had been made during the preparation of the report included: the use of ECU conversion rates adjusted for exchange rate fluctuations of floating component currencies; denominating balances in the creditor's currency; the payment of a commission by the debtor to the creditor country; and multilateral sharing of exchange risks. He suggested that the proponents of each of those elements should send to the Secretariat a note detailing their suggestions; these would then be assessed by the Foreign Exchange Policy Sub-Committee which would report to the Governors in September.

The *Committee* endorsed the Chairman's suggestion.

(c) Fiscal consolidation in 1993

The *Chairman* invited the Committee to discuss the Economic Unit's note entitled "Fiscal consolidation in 1993" and suggested that the Committee should formulate an opinion on fiscal developments which he would present to the Ministers of Finance at the July ECOFIN meeting.

Mr. Fazio said that three factors were at the heart of the deterioration of public sector finances: structural deficits were not improving; the impact of the general economic situation; and the high level of interest rates. He agreed that the Committee had a contribution to make to this issue but suggested that the Governors should proceed carefully lest the Council of Ministers invited them to consider interest-rate levels. He added that attention should also be paid to the levels of savings and indebtedness in the private sector. Finally, in some countries such as Italy, the quality of public expenditure presented a serious problem.

Mr. Schlesinger said that he supported the Chairman's suggestion that the Governors should take an initiative on the question of public sector deficits. He noted that two problems were faced. Firstly, in the case of most countries, the Maastricht convergence criteria could not be attained by 1996 and would be lucky to be reached by 1998. The temptation in a number of countries, including Germany, to consider the Maastricht criteria as being too strict and, thus, to relax them, should be counteracted. Secondly, with respect to the reasons for the current deterioration in public finances, the Economic Unit's paper had concluded that during the period 1989-1992 both cyclical and non-cyclical factors had been at work. He stressed that cyclical phenomena should not be used as an excuse for the deterioration. Furthermore, the distinction was often made between the primary and the interest-rate balance with an increasing deficit being attributed to the rise in interest expenditure as a result of high interest rate levels. In reality, if expenditure, however it was comprised, was higher than income, the resulting deficit would need to be financed. Any other interpretation would obfuscate the importance of a country's deficit and discourage efforts being made to achieve a consolidation in the medium and long term. With regard to Mr. Fazio's observation about the level of savings and indebtedness in the private sector, he pointed out that, in the simplified model of a closed economy, the counterpart of a rise in the public sector deficit was necessarily an increase in private sector savings. Furthermore, the origin of a deficit should be considered: if a country's public sector deficit was caused only by paying interest or by encouraging consumption, this was worse from the point of view of the economy than if the deficit was caused by the financing of productive investments.

Mr. Leigh-Pemberton said that fiscal deficits were likely to be as much of a problem during the 1990s as inflation was during the late 1970s/1980s. It was now widely accepted that there was no easy way to obtain economic growth through the pursuit of inflationary policies. The challenge was to try to gain acceptance of a similar attitude towards fiscal deficits; he endorsed the suggestion that this issue should be emphasised at the ECOFIN meeting in July. To the extent that the public sector deficits were of a structural nature, governments needed to be encouraged to embark on consistent, medium-term policy programmes to eliminate them. In this context, he welcomed what Mr. de Larosière had said earlier in the meeting about the new French government's five-year plan to deal with the fiscal deficit in France. He agreed with the point made in the Economic Unit's paper that the Member States had failed to consolidate adequately the fiscal advantages that had presented themselves during the period of economic expansion in the 1980s. While some countries had had surpluses and had balanced their budgets, the level of public sector debt should have been reduced much further.

Mr. Doyle said that he was sceptical as to whether governments could be persuaded to maintain continuous downward pressure on fiscal deficits in order to lay the foundation for stable economic growth. He agreed with Mr. Schlesinger that it was artificial to draw a distinction between a country's primary balance and its interest-rate balance. He suggested that caution should be exercised in considering not only what to put into an opinion addressed to the ECOFIN Council but also the method by which it was presented. He was uneasy about the markets' reaction to any statement to the ECOFIN Council, which was likely to become public, which indicated that the Governors were at

odds with the economic policies being pursued by governments. He suggested that an oral report should be made by the Chairman rather than a formal opinion being delivered.

Mr. de Larosière said that he agreed with Mr. Leigh-Pemberton that the development of fiscal deficits which had led to the erosion of personal savings since the 1970s was disturbing. He also supported the Chairman's suggestion that the Governors' opinion of the deficit situation should be made known to the Finance Ministers at the July ECOFIN meeting. However, he did not agree that in so doing the Governors would be seen to be at odds with the Ministers since, in most Community countries, governments were discussing fiscal consolidation. The Governors' opinion could therefore be presented as a supportive action rather than as a dissenting view. He added that fiscal consolidation plans sometimes tended to "backload" corrective measures until subsequent years rather than giving them immediate impact. He agreed with Mr. Schlesinger that it was not the answer just to tackle primary deficits. Insufficient action had been taken in the past to correct fiscal positions in previous years of expansion.

Mr. Papademos, on behalf of Mr. Christodoulou, said that he endorsed the suggestion that the Committee should prepare an opinion to be delivered to the ECOFIN Council in order to encourage governments to implement fiscal policy aimed at stability. It was important that plans had been made in Community countries to address fiscal imbalances in the medium term, although it might be inappropriate in some countries to implement specific fiscal measures during a recession. Central banks should play a role in making governments more far-sighted in their pursuance of fiscal policy. In Greece, the public sector borrowing requirement had declined in the previous two years by 6% of GDP; however, there was a risk that this progress might be reversed as the date of the general election in Greece approached. The fiscal problem in Greece had to a considerable extent been the result of myopic fiscal policies related to the electoral cycle. He supported the Chairman's suggestion to make the Governors' views known to the ECOFIN Council.

Mr. Beleza also supported the Chairman's suggestion, particularly against the background that the Committee had said in its Annual Report that the present fiscal situation was unsustainable. He agreed with the comments made by Mr. Leigh-Pemberton and Mr. Fazio and noted that interest rates were currently at high levels as a consequence of the lack of fiscal discipline. He wondered whether this might be raised at the informal ECOFIN meeting on 21st May.

The ***Chairman*** said that he did not wish to take the Ministers by surprise. He proposed to announce, if opportune, at the forthcoming informal ECOFIN meeting that the Governors were preparing an opinion which he would present to the Ministers in July. In a response to a question from Mr. de Larosière, he said that he could see no drawback to distributing the Economic Unit's note to the Finance Ministers.

Mr. Christophersen said that the Finance Ministers would expect the Governors to have an opinion about the fiscal position. The Commission was going to present in June its revised economic forecast for 1993; a deterioration of the fiscal balance in a number of Member States, especially the United Kingdom and Germany, was now envisaged. The Commission was also due to assess the impact of the recently announced measures in France without which there would have been a serious deterioration of the French fiscal position. With reference to Table 1 of the Economic Unit's

note, he noted that the deterioration in fiscal balances in the Community of 2.5% of GDP between 1989 and 1992 could be analysed as follows. Cyclical effects accounted for 0.8 percentage point of the change with the remaining 1.8% being attributed to the consequences of the rise in nominal interest rates (0.6 percentage point) and to the non-cyclical, non-interest rate related part of the deterioration (1.2 percentage points). The table showed that in the period 1981 to 1984, a considerable improvement in the non-cyclical, non-interest rate related deficit had been achieved. For the Member States to redress the current fiscal imbalance, there would need to be sufficient growth to reduce or abolish the cyclical consequences, a substantial decrease in short-term interest rates and a reduction in structural deficits. Most Member States had submitted ambitious convergence programmes to the ECOFIN Council according to which they would meet the Maastricht convergence criteria in the fiscal year 1996. If the Finance Ministers were to be told that it was unrealistic to believe that the Maastricht criteria could be achieved by this time there was a risk that some governments would come under heavy pressure in their respective countries to be less ambitious. Therefore, a balance had to be found between keeping the pressure on governments while not discouraging them from proceeding with their current plans. He agreed that it would be appropriate for the Chairman to mention at the informal ECOFIN meeting in May that the Committee was preparing an opinion on the fiscal position which would be presented during the multilateral surveillance discussion in July. He would mention this to the Belgian Finance Minister when they met to discuss the agenda for the July meeting.

The ***Chairman*** said that the convergence criteria (most importantly the 3% deficit criterion) in the Maastricht Treaty had been formulated to ensure that EMU would be durable once Community countries entered Stage Three. Since the trend in Community countries was currently away from meeting those criteria, it was appropriate for the Governors to voice their opinion.

The ***Committee*** agreed that the Economic Unit's note, with some editorial adjustments, could be made available to the Finance Ministers. A draft opinion was to be prepared, which would be considered by the Governors at their June meeting, and be delivered by the Chairman to the ECOFIN Council at its July session.

VII Date and place of next meeting

The next meeting of the Committee will take place at the BIS in Basle on Monday, 14th June 1993.

276TH MEETING OF THE COMMITTEE OF GOVERNORS
11th May 1993

Chairman	Mr. Duisenberg
Banque Nationale de Belgique	Mr. Verplaetse Mr. Rey[1] Mr. Michielsen
Danmarks Nationalbank	Mr. Hoffmeyer Mrs. Andersen Mr. Hansen
Deutsche Bundesbank	Mr. Schlesinger Mr. Tietmeyer Mr. Rieke
Bank of Greece	Mr. Christodoulou Mr. Papademos Mr. Stournaras
Banco de España	Mr. Rojo Mr. Linde Mr. Durán
Banque de France	Mr. de Larosière Mr. Hannoun Mr. Robert
Central Bank of Ireland	Mr. Doyle Mr. Coffey Mr. Reynolds
Banca d'Italia	Mr. Fazio Mr. Dini Mr. Santini
Institut Monétaire Luxembourgeois	Mr. Jaans
Nederlandsche Bank	Mr. Szász Mr. Bakker
Banco de Portugal	Mr. Beleza Mr. Gaspar Mr. Carvalho
Bank of England	Mr. Leigh-Pemberton Mr. Crockett Mr. Clark
Commission of the European Communities	Mr. Christophersen Mr. Pons
Chairman of the Foreign Exchange Policy Sub-Committee	Mr. Saccomanni
Secretariat of the Committee of Governors	Mr. Baer Mr. Scheller Mr. Viñals

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[1] Chairman of the Committee of Alternates