

**MONETARY POLICY INSTRUMENTS AND PROCEDURES IN
STAGE THREE
- Further issues for discussion -**

The following issues for discussion deal with topics about which the Sub-Committee only held a preliminary exchange of views during its meetings in December 1992 and May 1993.

A. RESERVE REQUIREMENTS

Reserve requirements have different functions, some of which are not directly linked to the conduct of monetary policy (for example, ensuring profits to the central banks or contributing to the security of interbank payments). As regards the monetary policy sphere, reserve requirements may help to stabilise the demand for high-powered money (possibly reducing the frequency of central bank operations) and to enhance the controllability of the money supply by enhancing the leverage of the central bank or commercial banks' behaviour. However, the effectiveness of reserve requirements in stabilising the demand for base money depends crucially on the averaging provisions and the level and remuneration of the coefficient, provided that the compulsory reserves are above the level that commercial banks would otherwise maintain for settlement purposes. In addition, it has been argued that the stabilising properties of reserve requirements could be partially reduced by the instability that emerges at the end of the maintenance period.

How significant are the improvements in the implementation of monetary policy which are brought about by the adoption of reserve requirements? Are they more relevant on the controllability side or on the stabilising side? To what extent can the instability at the end of the maintenance period reduce the effectiveness of reserve requirements in stabilising the money market? How should reserve requirements be set (in terms of level, remuneration, averaging provisions, etc.) to guarantee that their potential benefits offset the distortions and the loss of competitiveness of the banking sector implied by the implicit tax associated with the adoption of this instrument?

B. HARMONISATION OF OTHER MPIPS

A high degree of harmonisation of MPIPs would make it easier for market participants to understand the monetary policy intentions of the ESCB. Furthermore, it has been suggested that insufficient harmonisation could give rise to undesirable regulatory arbitrage and lead to the

delocalisation of financial activity. On the other hand, it has been argued that harmonisation should not be complete, but certain national features of MPIPs should be maintained on the basis of cost considerations and of the familiarity of market participants with existing procedures and instruments.

What are the principles which can guide the harmonisation process to strike a balance between the two positions sketched above? Can some guidelines for determining the terms of harmonisation be already outlined?

C. DECENTRALISATION OF MONETARY POLICY IMPLEMENTATION

In the choice of the degree of decentralisation of monetary policy implementation in Stage Three, the principles of efficiency and subsidiarity have to be reconciled. The extent to which these two principles imply contrasting prescriptions depends on a number of factors and on the choice of MPIPs in particular. For example, it has been pointed out that, if differences in the functioning of national interbank markets remain significant after the start of Stage Three, a higher degree of decentralisation in the execution of monetary policy might be required. Further, it has been argued that a scheme based mainly on standing facilities seems easier to be implemented in a decentralised fashion, although national central banks could also be involved in the execution of monetary policy if the conditions and the frequency of open market operations were fully harmonised. In contrast, overnight or very frequent fine-tuning open market operations could prove difficult to decentralise.

What are the criteria to assess the desirable degree of decentralisation in the implementation of the single monetary policy? How much discretion left to NCBs is compatible with the unitary character of monetary control? Should the implications of MPIPs for the issue of decentralisation play an important role in the choice of the operational features of monetary policy in Stage Three?

What is the relationship between the role played by reserve requirements, the degree of harmonisation of MPIPs and the degree of decentralisation of monetary policy implementation in Stage Three? In particular, do Sub-Committee members agree that the key feature for distinguishing among different "models of implementation" is the frequency of central bank intervention in money markets?