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TELEFAX

COMMITTEE OF GOVERNORS OF THE CENTRAL BANKS
OF THE MEMBER STATES
OF THE EUROPEAN ECONOMIC COMMUNITY

SECRETARIAT

Basle, 7 June 1990

Deutsche Bundesbank
For the attention of President Pöhl
(Copy for Messrs Rieke and Schlüter)
Tfx No: 00 49 69 56 40 82

With a view to the forthcoming ECOFIN Council session on 11 June 1990, please find attached two speaking notes which have been prepared by the Secretariat following consultations with the Bundesbank's International Department.

Kind regards

A Bascoul

Attachment: 6 pages

TELEFAX

Committee of Governors of the
Member States of the Central Banks
of the European Economic Community

Secretariat

7 June 1990

SPEAKING NOTE FOR PRESIDENT PÖHL

ECOFIN COUNCIL SESSION ON 11 JUNE 1990

Re: Economic and Monetary Union

This morning the Committee of Governors finalised its preparations for the start of Stage One of Economic and Monetary Union. It has adopted a new set of rules of procedure which enshrine the revision of the Committee's structure and working procedures. The Committee of Governors is confident that these organisational changes will contribute to strengthening further central bank co-operation and monetary policy co-ordination and, in particular, will enable it to fulfil the tasks conferred upon it under the amended Council Decision on co-operation between Community central banks. In accordance with Article 3 of this Council Decision, which stipulates that the Committee shall normally be consulted before the national authorities take decisions on the course of monetary policy, the Committee will develop a common framework for the monitoring thereof. This exercise will include both ex ante examinations and ex post assessments and will be part of Community central banks' anti-inflation strategy.

I mention this point especially in view of the critical role of Stage One of Economic and Monetary Union for further monetary integration. Indeed, the first stage is designed to achieve greater convergence towards more price stability which in turn is a necessary condition for stable exchange rates in accordance with the requirements of the EMS.

Since the informal ECOFIN meeting at Ashford Castle, the Committee of Governors has pursued its deliberations about the subsequent stages of Economic and Monetary Union. The Committee's work has focused especially on the structure of the Community monetary institution which will be created in this context. Although work is still in process, broad agreement has emerged on a number of basic principles.

The new Community monetary institution should primarily be committed to price stability. Only under this condition would Community countries with a stable currency be prepared to transfer their monetary sovereignty to the new Community institution. The primary task of this institution, which I will call the European Central Banking System (ECBS), would be the formulation and implementation of the Community's monetary policy. With respect to external monetary policy, a balance between the ECBS and the political authorities will have to be found; by analogy to the present distribution of competences, decisions on the exchange rate regime and the fixing and adjustment of central rates would fall within the competence of the political authorities in consultation with the ECBS. At the same time, the ECBS should be responsible for the implementation of exchange rate policies, the management of foreign exchange reserves and interventions in the foreign exchange markets. Foreign exchange interventions are an important channel of money creation and cannot be undertaken independently of domestic monetary policy considerations.

The ECBS should also assume responsibility in respect of the payments systems and participate in the co-ordination of activities in the field of banking supervision, given growing integration of the Community's financial markets and banking activities.

There is broad agreement among the Governors that the ECBS should be vested with the sole responsibility for monetary policy; only in this way, can it be ensured that the Community's monetary policy remains geared to the primary objective of price stability. There is a broad consensus that the ECBS should be independent of other Community bodies as well as national governments in monetary policy decisions. This will especially mean that the ECBS and the members of its organs are not subject to instructions from other Community bodies or national governments. To that end, the members of the ECBS organs should have appropriate security of tenure. In this context, the Commission has proposed that the members of the Board be appointed for a term of five years; this appears to be rather short. In addition, the central bank Governors, who will also be members of the supreme decision-making organ of the ECBS, should be given the same security of tenure; this will necessitate a revision of national central bank statutes in some countries.

The independence of the ECBS will also have to be secured by the preclusion of monetary financing of public sector deficits, both at Community and national level. The independence of the ECBS as outlined above is fully compatible with the principle of democratic accountability. The ECBS would be created by a Treaty which needs to be ratified by national parliaments, its powers would be clearly defined and the members of its organs would be appointed by democratically legitimised political authorities. In addition, there should be relationships with the European Parliament along the lines which already exist for the Committee of Governors, namely that the President of the ECBS would describe the Community's monetary policy to the European Parliament at the occasion of the presentation of the annual report and might also be invited to sessions of the competent committee of the European Parliament where circumstances so justify. In addition, there would be co-operation with the Council and the Commission.

The unity of the Community's monetary policy should also be ensured by an adequate structure of the ECBS. At Ashford Castle, it was agreed that the ECBS would be federally-structured. This principle should not mean that national central banks would still enjoy decision-making powers in respect of monetary policy. The formulation of monetary policy should instead lie with a central council on which all central bank Governors would be represented together with the members of the Board. In this context, I would like to make two remarks on the note presented by the Commission. First, the Governors are in general in favour of decision-making by simple majority, each member having one vote. A weighting of votes would have the drawback of promoting regionalisation. Second, the central element in the decision-making process should be reinforced. Most Governors are in favour of a higher number of Board members than the four proposed by the Commission.

The Governors feel that the basic principles of Economic and Monetary Union should be enshrined in the Treaty to give them a "constitutional rank". From the monetary point of view, this would in particular be:

- the primary objective of price stability;
- the unity of monetary policy to be conducted by the ECBS;
- the independence of the ECBS;
- the irrevocably fixing of parities, the abolition of fluctuation margins and the eventual creation of a single currency;
- the preclusion of monetary financing of public sector deficits and the absence of "bailing out".

The deliberations of the Governors have so far focused on the final stage of Economic and Monetary Union, but transitional issues also need careful examination. A choice will have to be made between the following options: continuation of Stage One until all Community countries are ready to move to the final stage of EMU, a transitional stage (i.e. Stage Two of the Delors Report) during which tasks would progressively be transferred to ECBS, the integration at different speeds, or a combination of these options. These options have, of course, political and economic relevance. An approach, which on a temporary basis would only include some Community countries, might be more realistic but its implications for the cohesion of the Community are manifest.

The Governors will pursue their deliberations in summer on the basis of works which are at present being prepared by their Alternates. They will come back on this issue in September at the informal ECOFIN conference.

Committee of Governors of the
Member States of the Central Banks
of the European Economic Community

Secretariat

7 June 1990

SPEAKING NOTE FOR PRESIDENT PÖHL

ECOFIN COUNCIL SESSION ON 11 JUNE 1990

Re: Multilateral surveillance

I would like to focus my remarks on the consistency between monetary policy and other economic policies, in line with Article 7 of the Council Decision on the attainment of progressive convergence of economic policies and performance during State One of Economic and Monetary Union.

Prospects are for a continuation of strong economic growth in the Community. However, the macro-economic situation in the Community raises concern in two respects. First, inflation remains resilient. The year-on-year inflation rate of the Community as a whole amounts to more than 5%. Hopes that there would be some deceleration have not materialised. The resilience of inflation especially reflects domestic factors, namely demand pressures and capacity constraints, on the one hand, and rising wage claims, on the other. Second, the move towards greater convergence of economic fundamentals in the Community has come to a halt; thus, sizable divergences still exist and in some cases there has been some aggravation. This has, in particular, been the case between countries inside the EMS exchange rate mechanism, one the one hand, and those outside, on the other, but convergence still remains incomplete within the EMS exchange rate mechanism countries in some respects. Clearly, these trends are not in line with the declared aims of Stage One of EMU, namely "greater convergence with a view to achieving domestic price stability".

Against this background, a tight stance of macro-economic policies will be needed in order to check inflationary pressures. Policy responses will have to be differentiated in line with the aim of achieving greater convergence. However, monetary restraint alone will not be sufficient to cope with this double challenge. The tightening of monetary policies implemented by Community countries will exert the desired effects only if the policy mix is more appropriate. This is all the more true in an environment of fully liberalised capital flows where the room for independent monetary policies is limited. The Committee has welcomed the recent liberalisation measures in several EMS countries but stresses that this will reinforce even more the need for greater support from other economic policies.

The Committee of Governors' last examination of recent developments in public finance came to the conclusion that the present situation does not comply with this requirement. Although it was noted with satisfaction that the Community's aggregate general government deficit has been reduced further, it is also obvious that this development was only in part due to fiscal adjustment measures. Moreover, the move towards sounder fiscal policies has remained uneven. By and large, the consolidation efforts are producing significant results in countries where the budgetary situation is already less worrying, whereas there is a striking absence of progress where it is most needed. This is particularly the case in Italy and Greece. In Portugal the trend towards a reduction of the budget deficit will be reversed this year. In some other countries the budgetary situation has remained fragile, despite progress towards reducing structural disequilibria; the high level of public debt underlines the potential risk of destabilisation given the exposure to adverse interest rate movements.

Present budgetary projections do not suggest much further progress in fiscal consolidation in the near future. However, such progress would be highly desirable given the present cyclical situation, the reduction in savings ratios and the prospect of increased demand for capital in connection with developments in central and eastern Europe. A more pronounced tightening of budgetary policies would be particularly appropriate in those countries where public deficits remain excessive. A tightening in Germany would help to limit the adjustment requirements in the rest of the Community. Failure to achieve more decisive fiscal consolidation would imply a continued overburdening of monetary policies and would entail the risk of jeopardising their co-ordination in the framework of the EMS.