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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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List of participants attached

The *Chairman* opened the meeting by welcoming Mr. Fazio and congratulated him on his appointment as Governor of the Banca d'Italia. He asked that the Committee's best wishes be passed on to Mr. Ciampi. He also welcomed Mr. Clark who had taken over from Mr. Foot as the Bank of England's second Alternate.

I Approval of the minutes of the 275th Meeting

The *Committee* approved the minutes of the 275th meeting.

II Monitoring of economic and monetary developments and policies in the Community

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

The Monitoring Group had noted that the tensions that had characterised the EMS in the previous two months had significantly abated in April, as indicated by the fact that interest-rate differentials between Germany and the other EMS countries had narrowed on average by 0.5 percentage point and that all ERM currencies had moved within a range of less than 2 percentage points.

The situation in a number of countries had been reviewed. Firstly, the position of the Spanish peseta remained uncertain, although tensions had diminished following the co-ordinated interventions of several ERM central banks together with the Banco de España in late April. The origins of the pressure on the peseta had been entirely political and the Spanish representative had reported on the economic factors underpinning the policy of exchange rate stability being pursued. It was felt, however, that the real test could come in the run-up to the general elections on 6th June. Secondly, the weakening of the Danish krone had not been justified by the domestic economic situation, but appeared to have been motivated by uncertainties about the result of Denmark's second Maastricht referendum which had led foreign holders of krone-denominated bonds to hedge their risks. Thirdly, the situation in the French money and foreign exchange markets had improved: the French franc had strengthened; interest rates were significantly lower; and large reflows had been recorded. The markets' attention was currently focused on the impact of the measures announced by the new government to check the deterioration in public finances, which was more serious than had been expected, and to stimulate economic activity in the productive sector.

The Group had also reviewed the outlook for interest rates in the Community countries which, with the exception of Spain and Portugal, had been declining or had remained stable. In particular, market interest rates had fallen in Italy where the lira had strengthened significantly following the formation of the new government. In the United Kingdom, interest rates had remained stable; as the economic recovery was becoming more firmly established, the markets did not expect any further reductions in interest rates, but did not rule out that they might firm. Interest rates were also stable in Greece, where the central bank had just announced the removal of all foreign exchange restrictions on capital transactions of a maturity beyond 12 months. In general, there seemed to be a looser relationship between interest rates in Germany and those in other Community countries where interest-rate trends reflected the evolution of domestic economic fundamentals.

Finally, the Group had briefly discussed central bank intervention in the foreign currency options market; this discussion had been prompted by unfounded press reports of such interventions by the Banco de España. No EMS central bank had so far undertaken interventions using options, although this had been considered by some. Although a better knowledge of the instrument was needed, the view was expressed that such interventions might be counterproductive and might not contribute to enhancing the perception of market participants of two-way risk.

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

The Spanish representative had given the Alternates an account of the most recent economic trends in Spain, where the existing imbalances were currently being corrected. Indicators such as those relating to competitiveness, trade, price developments, public sector deficit trends and money supply data, had led to the conclusion that the present parity of the peseta was sustainable. Doubts had, however, arisen in the markets because of the political uncertainties linked to the forthcoming general elections in Spain. The currency had occasionally come under heavy pressure, which had been successfully resisted so far owing to the determined use of all of the Basle/Nyborg instruments. Concerted interventions involving a number of central banks had played an important role; one Alternate had feared, however, that this tool might quickly be eroded in the absence of a clear political commitment to defend the parity. Speculation had abated more recently. The Banco de España was aware that the foreign exchange markets would undoubtedly remain unstable until the political situation was clarified.

With regard to the Danish krone, the Alternates had received a presentation similar to that given to the Monitoring Group. Turning to the United Kingdom, the evidence seemed to point to a more firmly established recovery without domestic inflationary developments. The downward adjustment of interest rates had, however, run its course ahead of developments elsewhere, and no further action was contemplated even if the trend reduction in interest rates was pursued in other countries. Although there was no exchange rate target in the United Kingdom, the recent strengthening of the pound sterling had been welcomed. Fiscal policy, on the other hand, would need to be tightened.

3. Discussion by the Committee

Mr. Rojo thanked those central banks which had taken part in the concerted intervention in support of the peseta on 23rd April. The current situation, and the attacks which had been mounted against the peseta, had not been due to an inadequate competitive trade position, but had been caused by the serious political uncertainty in advance of the forthcoming general election. The two principal parties in Spain were evenly positioned according to the most recent opinion polls; the uncertainty was likely to persist in the markets even though both parties had made strong statements in favour of the maintenance of the peseta in the ERM at its current parity. With reference to a recent article in *The Economist* magazine, concerning the intervention by the Banco de España in the options market, he said that the market for Deutsche Mark/Spanish peseta options was very thin and that the Banco de España had abandoned the idea of using this market after giving the matter consideration. Since the daily turnover in the Spanish options market was below DM 300 million, it was absurd for it to be reported that the Spanish central bank had used the options market in amounts of DM 1 billion per day.

With regard to the measures which had recently been taken in Greece to liberalise capital movements in accordance with the Community directives, ***Mr. Christodoulou*** said that the Greek authorities had felt that the time had been appropriate since the balance of payment figures had indicated some favourable developments. Restrictions currently remained only on certain categories of short-term loans and on foreign currency deposits by residents with a maturity of less than one year.

Mr. Hoffmeyer queried the difference between a central bank taking positions in the forward market and in the options market.

Mr. Saccomanni said that central bank transactions in options, if they became known, might give the impression to the markets that a central bank was running out of reserves and wanted to have an impact on the foreign exchange market without utilising those which remained. Furthermore, options markets were thin except for major currencies and intervention by central banks in these markets might provide too much assurance to options holders and not a sufficient perception of risk. However, the view had been expressed that more work should be done in this area since a number of central banks had said that they were considering the use of options as an instrument.

Mr. Schlesinger said that the Deutsche Bundesbank was continuing to assess how far it could reduce short-term interest rates in Germany without adversely affecting the situation in the capital market. The discount rate (by 0.25%), the Lombard rate (by 0.5%) and the repo rate had been reduced recently; since then bond yields had risen by approximately 0.2 to 0.3 percentage point and the Deutsche Mark had eased in the foreign exchange markets. This suggested that a critical point had been reached, and a cautious approach towards cutting interest rates further was necessary; it made no sense to follow the advice of some international newspapers of reducing interest rates in one step by 1 or 2 percentage points. This was also not appropriate against the background of strong monetary expansion in Germany. The main stimulus to monetary growth was given by lending to the private sector (including the Treuhandanstalt and the Federal Railway System) which was growing at an annualised rate of 9% to 9.5%, and to public authorities. The use of the bond markets for raising credit was increasing even faster. A downswing in economic activity in western Germany was recorded in the second half of 1992 which, in itself, would have led to a decline in GDP of more than 1 percentage point. However, given the further downswing in the first quarter of 1993, and the expectation that this would continue in the second quarter, it was estimated that average GDP in western Germany in 1993 compared with the average for 1992 would decline by about 2%. On the other hand, GDP in eastern Germany was likely to expand by 5% in 1993; with investment in equipment growing by between 10% and 15% in real terms and building activity by around 18%. In western Germany, the annual rate of inflation, after the increase in VAT at the start of 1993, had remained at approximately 4.3% between February and April while, in eastern Germany, the expected rate of inflation had been between 8% and 9% (the proportion attributable to increases in administered prices was declining while the impact of strongly rising wages and salaries was increasing). These developments, together with the fiscal situation, would not allow monetary policy to be relaxed.

The *Chairman* asked Mr. Schlesinger to what extent the subsidised interest rates available to promote investment in eastern Germany were temporary.

Mr. Schlesinger said that there were different programmes of assistance, the most important being in the field of housing where the available credit financed through the Kreditanstalt für Wiederaufbau had been increased by DM 30 billion to DM 60 billion. Most of the programmes were to run without time limit, although limits existed as far as the amount of subsidies was concerned. Limits also applied to special credit institutions which were able to use tax breaks to subsidise interest rates. In response to a question from Mr. Hoffmeyer, he added that, on an annualised basis, German money supply in April would be within the target range for 1993 of 4.5% to 6.5%. This target range, however, had been set with reference to the average level of the broad money stock in the fourth quarter of 1992 which had been boosted by the currency inflows of last autumn. The Deutsche Bundesbank had not attempted to correct this base shift. In the first three months of the current year, the money growth had been below this range as a result of currency reflows out of Germany but, as these flows had come to an end, monetary growth was accelerating again.

Mr. de Larosière said that interest rates in France were on a downward trend without being forced in this direction by central bank action. The three-month interest-rate differential vis-à-vis Germany was currently 18 basis points compared with more than 100 basis points a month earlier; the daily call market rate had fallen from 9.375% to 8.1875%. The steady decline had been achieved at the same time as the French franc had strengthened. Furthermore, the Banque de France's indebtedness arising from intervention support operations had been repaid in full and its currency reserves had been restored to around 90% of the level that had existed before the ERM crisis began. However, the budgetary situation in France had deteriorated under the impact of the slowdown in economic activity. In 1992, the public sector deficit had been 3.8% of GDP and, in 1993, the State deficit would have risen to 4.8% of GDP (Fr.fr. 340 billion) before allowing for the corrective measures which had been announced the previous day. These measures included increases in the price of gasoline, tobacco and alcohol, and reductions in government expenditure, and more than offset stimulatory measures comprising a reduction in employers' contributions towards family allowances, measures to re-stimulate the housing market and some which would affect agriculture. The net result would be a reduction of the State deficit to Fr.fr. 316 billion. Action, such as substantial increases in the contribution sociale generalisée paid both by employers and employees, was also taken to reduce the growing deficit in the social security system, which would otherwise have risen to Fr.fr. 50 billion in 1993, adding to the deficits of a similar amount run since 1990. The package as a whole represented part of a five-year plan to reduce the public sector deficit to around 2%-2.5% of GDP.

Mr. Fazio said that in the next few days the new Italian government would present its adjustments to the 1993 budget together with an update of the three-year plan in which the evolution of the public finances for the next three years was set. He would inform the Committee of the details once they were available. He added that he could not remember a time in the past thirty years when real interest rates had been so high and growth so low. Furthermore, the ratio of the public sector deficit to GDP was at a record level; while it was necessary to maintain an expectation of decline in this ratio, it would be imprudent to force the pace too much.

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 oversight of the ECU clearing, a majority of Sub-Committee members had supported the view that the present arrangements should be maintained, specifically those regarding the roles played by the EBA and the BIS. Some members had advocated a more active role for the EMI, particularly regarding liquidity recycling facilities, or had suggested that it should take over from the BIS the settlement function in the clearing system. Thirdly, on the task of facilitating the use of the ECU, there was agreement on the principle that either negative or positive discrimination should be avoided but that the EMI should do sufficient to give tangible content to Article 4.1 of the EMI Statute.

The Sub-Committee was ready to conduct the appropriate follow-up work and to establish contacts with the competent Working Groups on the horizontal issues that had emerged.

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

The Alternates had expressed their appreciation for the high quality of the interim report. They had noted that there were a number of controversial points, particularly in respect of the potential reserve management function of the EMI. The areas of disagreement essentially reflected differing views as to the desired degree of visibility of the EMI in the financial markets. It had been noted that these issues had already surfaced during the negotiation of the Maastricht Treaty; in the opinion of some Alternates, most of these issues had been settled by the wording of the Treaty and should therefore not be re-opened. In contrast, other Alternates had considered that some articles of the Treaty were still open to interpretation; if a too restrictive interpretation were to be given, they saw a risk that the EMI would be an "empty shell". The Alternates had found it premature to attempt to settle these issues which would have to be decided by the Council of the EMI and should probably only be taken up when this body had been established, or was about to be. In the meantime, the Secretariat should prepare the legal instruments which would be needed to ensure the smooth transition from the EMCF to the EMI.

3. Discussion by the Committee

Mr. de Larosière said that he agreed with the Alternates' suggestion that any decisions on these issues be postponed until the EMI had come into existence. He then made the following remarks. Firstly, the text of the Statute of the EMI did not make it possible to restrict the composition of the reserves that could be held by the EMI to non-Community currencies as Article 6.2 entitled the EMI to "receive monetary reserves"; it was also not possible to exclude deposits from appearing on the EMI's balance sheet because Article 6.4 referred to national central banks "depositing their reserves". Secondly, with regard to the question of who should bear the costs incurred by the EMI, he recalled that the Treaty text was a compromise between the views of those countries which did not want the EMI to have any involvement in the management of reserves and those which would have liked the EMI to have a more systematic function in this regard; it would be reasonable for the EMI to bear the cost of the service it would make available to those central banks which wished to us it. If a fee was to be levied, a large part of the substance of the EMI would be removed.

Mr. Schlesinger agreed that the issues raised in the Sub-Committee's report should be left open for the time being. However, the principle should be borne in mind that responsibility for monetary policy during Stage Two of EMU would rest exclusively with the respective national authorities. The question of whether the EMI should be able to hold reserves denominated only in non-Community currencies, or also in Community currencies, was important in determining to what extent the activities of the EMI might influence the execution of national monetary policy. It was not currently clear which country would be prepared to transfer its currency reserves to the EMI; none would be obliged to do so except in respect of its EMCF obligations.

The ***Committee*** agreed not to discuss the subject further; it would have to be considered again in the Council of the EMI.

(b) Conditions of employment of the EMI

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

The Alternates had discussed a progress report from the Heads of Personnel on the preparation of proposals for employment conditions in the EMI. Their work had so far focused on: salary structure; staff representation; pensions; and a staff handbook. Subject to further elaboration, the preliminary view was that the salary structure could largely be modelled on that of the European Commission. For pensions, the approach to be followed should allow seconded staff to remain in the pension scheme of their respective central banks (contributions to be reimbursed by the EMI), with the pension scheme being modelled on that of the EC Commission for temporary staff. With regard to staff representation, this function should be set up in-house rather than using an external body. Lastly, a staff handbook which set out the rights and obligations of staff should be drawn up and referred to in the employment contract between the EMI and individual members of staff.

There had been broad agreement among the Alternates on the thrust of the report although a number of points would require further consideration; two in particular were mentioned. Firstly, some Alternates had felt that the EMI should have a degree of flexibility with regard to the distribution of nationalities of its staff, whereas one Alternate had favoured a more concrete formula and had suggested that the Heads of Personnel should explore this issue further. Secondly, some Alternates had questioned the rationale for an expatriate allowance and had expressed preference for the payment of specific allowances, for example in respect of education abroad. Several Alternates had pointed to the need for the Governors to consider practical steps to ensure the maximum degree of continuity in the Secretariat to support the work of the Committee.

2. Discussion by the Committee

The ***Chairman*** said that the functioning of the Secretariat was increasingly hampered by the uncertainty over the timing of the establishment and the site of the EMI; Mr. Baer was having difficulties in filling vacancies. He had asked Mr. Baer to draw up a check-list of decisions which the Governors would have to take in respect of the transitional period up until the time when the EMI was fully functioning; this could be considered by the Governors at their July meeting.

Mr. Schlesinger said that the issue of whether the staff of the EMI should receive expatriate allowances could present difficulties and would need to be discussed at a future stage.

Mr. Leigh-Pemberton said that he supported the basic thrust of the report by the Heads of Personnel; work relating to the terms and conditions of employment for the staff of the EMI should be continued. He agreed with Mr. Schlesinger about the matter of expatriate allowances, which should in general be avoided. He added that he would strongly oppose the selection of staff on the basis of national quotas, rather they should be selected on merit. Furthermore, it would be helpful if the Committee was to indicate that it would deal sympathetically and generously with those members of staff in the Secretariat who might experience personal problems as a result of the transition to the EMI.

The ***Committee*** concluded that the principles set out by the Heads of Personnel represented a good starting point, although some issues would need further consideration. However, any decisions should be postponed until nearer the time of the creation of the Council of the EMI. Meanwhile, the Secretary General was requested to draw up a list of decisions which would need to be taken for the transitional period between now and early 1994, and to present a report for the Committee's July meeting.

(c) Secondary Community legislation for Stage Two of EMU

At the ***Chairman's*** invitation, ***Mr. Christophersen*** informed the Committee of the five issues regarding which secondary Community legislation was required: the excessive deficits procedure; how to prevent privileged access to financial markets; specifications regarding the prohibition of central bank financing of the public sector; a definition of the statistical data to be provided by the Commission for the determination of the key for the financing of the EMI; and rules for the consultation procedures between Member States and the EMI. Additionally, in the light of the report which the Chairman was due to present at the forthcoming informal ECOFIN meeting concerning the lessons to be learnt from the EMS crisis, the Commission would consider whether it should make a proposal for strengthening the multilateral surveillance procedure. He added that draft proposals from the Commission were to be ready for submission to the Council of Ministers by the summer but the question needed to be addressed whether the Commission should come forward with any proposals before the Treaty had been ratified in the United Kingdom and the case before the Constitutional Court in Germany had been concluded. On the other hand, the timetable for a timely adaptation of the legislation would be called into question if the ratification process was delayed until October. While the adoption of legislation on the non-monetary elements of Stage Two could be postponed for a few months, legislation on the key for the financing of the EMI and the consultations between the EMI and the Member States should be adopted by 1st January 1994. He had had discussions with representatives of the European Parliament with a view to ensuring that the Parliament's opinions could be prepared in the relevant sub-committees during the summer. It was hoped that the Parliament's opinions could be obtained in October, thereby allowing time for a final decision to be made by the ECOFIN Council in December. He added that it would not be possible to get formal approval for the necessary pieces of secondary legislation before the Treaty had been ratified in all Member States.

Assuming that the ratification process was concluded in Denmark and the United Kingdom in the second half of the current year, the ***Chairman*** asked whether it would be possible for the EMI to be established on 1st January 1994 but only to become functional a few months later because of delays in the Community's legislative procedure. For example, the decision on the site of 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