

Fifth meeting of the Committee in Basle
10th January 1989

The meeting was held at the BIS in Basle. It started at 10.15 a.m. and ended at 5.30 p.m. with a lunch break between 1.15 and 2.30 p.m.

The meeting was devoted to the discussion of a new draft of Part III of the report, issues relating to the ECU and some organisational questions.

1. Part III of the report

(a) General discussion

The general discussion of Part III centred mainly on a review of the two scenarios presented in Stage I, with a particular emphasis on the question of whether it would be desirable to describe two alternative scenarios in the final report.

A large number of Committee members expressed reservations about Scenario B, the main feature of which was the establishment of a European Reserve Fund (ERF). The main objections included:

- doubts whether an ERF was really needed; most of the tasks assigned to the ERF could in principle be performed by a strengthened Committee of Governors, possibly supported by additional committees and a permanent research staff. These auxiliary committees could be set up within the existing institutional framework;
- the objectives of the ERF gave the impression of overemphasis on exchange market interventions vis-à-vis third currencies as a means of improving the working of the EMS; monetary policy

- co-ordination was mentioned only as a second task, although it should be the main instrument for enhancing EMS cohesion;
- the creation of the ERF constituted an institutional step which in accordance with Art. 102A implied a procedure prescribed in Art. 236, i.e. the conclusion of a Treaty; setting up the ERF on the basis of a Council resolution and, where necessary, changing national legislation was not considered to be an acceptable alternative;
- some members were concerned that limiting the participation in the ERF to member countries observing margin obligations within the narrow band would institutionalise the separation of Community countries into two groups.

The supporters of the idea on an ERF stressed the importance of an early institutional step which would have great symbolic value and, in contrast to Scenario A, would impart stronger dynamism to the process of monetary integration. Moreover, in their view Scenario B constituted a qualitative leap which was desirable in view of the increased need for a jointly agreed and managed monetary policy at a time when capital movements were fully liberalised. However, some of the supporters of Scenario B acknowledged the legal difficulties.

During the discussion a consensus evolved not to present two scenarios in the final report, but to attempt to make only one proposal outlining the concrete steps towards economic and monetary union. The first stage under this proposal should include all the elements of Scenario A, as well as all features of Scenario B, except (a unanimous endorsement of) the ERF. In particular, it was agreed that Stage I should contain the following recommendations:

- to take (immediately or at least as soon as possible) the political decision to prepare a new Treaty and to conclude quickly the negotiations and the ratification of this Treaty; the Treaty should contain a detailed description of the main features of the final stage of economic and monetary union, as outlined in Part II of the final report, as well as indications of the condition under which Stages II and III should be implemented; however, it was pointed out (by Andriessen) that parliamentary

approval of a comprehensive Treaty leading all the way to economic and monetary union could be expected to be obtained only if the conditions and requirements for a move to the next stage were very carefully drafted. Otherwise there would be a danger that the Treaty would not pass parliaments, because parliamentarians would fear that in the long run they had to transfer power to something that was not exactly known;

- to implement a set of measures designed to strengthen - within the existing institutional framework - the co-ordination of fiscal and monetary policy; to this end both the 1964 mandate of the Committee of Governors and the 1974 convergence decision should be revised;
- to set out a list of specific measures and objectives which would include:
 - full participation of all Community countries in the narrow band of the exchange rate mechanism of the EMS;
 - full implementation of the programme for capital liberalisation;
 - recognition that during Stage I exchange rate realignments remained a useful instrument of adjustment;
 - adoption of a set of rules (covering exchange rate behaviour, monetary policy targets, budget targets, tax measures, social policy and cost developments) which would help to measure economic performance and guide policy decisions;
 - setting-up of three committees (on banking supervision, monetary policy co-ordination, exchange rate policy co-ordination) and a research staff;
- to strengthen the independence of national central banks;
- to ask the European Council to declare publicly that the currency of the future European monetary union would be the ECU;
- to remove all restrictions on the commercial use of the ECU;
- to begin Stage I at the latest with the completion of capital liberalisation on 1st July 1990 or perhaps earlier, i.e. when the political decision to prepare a Treaty was taken.

It was also agreed that the presentation of Stage I should point out that some Committee members advocated the establishment of an ERF, contain a description of its rationale and its features and explain that in the architecture of the Treaty the creation of the ERF could be considered as a first step (an embryo of the future European central banks system) to be subsequently followed by a second step setting up the full system. This view would be balanced by a short description of the reservations of those opposed to the ERF idea (see above), but it would also mention that these Committee members could envision a partial pooling of official reserves before the implementation of the final stage.

(b) Drafting suggestions

During the discussion of Part III a number of drafting suggestions were made:

Pöhl provided written drafting suggestions on arguments in favour of Scenario A.

Hoffmeyer felt that there was an inconsistency between the principle of indivisibility stated on p. 2 and the description of stages which seemed to suggest a possibility of transferring gradually decision-making power in the area of monetary policy; he also pointed out that some of the passages saying that "the Committee was of the view" were not logical because there was no option if economic and monetary union was to be achieved.

Ciampi stressed that in Stage I (p. 5) a clear reference had to be made to the consequences of full capital liberalisation in 1990 and that on p. 9 a stronger formulation concerning recommendations on monetary policy should be introduced and that it should be added that the ESCB should intervene to stem unwarranted capital movements.

de Larosière said that the rationale for including only the participants in the narrow exchange rate band in the ERF should be stated (namely that common interventions would be made with a view to, and would have an influence on, the exchange rate relationship of currencies in the narrow band); he also wondered whether it was wise to suggest on p. 10 a narrowing of the exchange rate margins.

Duisenberg asked to reconsider the suggestion on p. 10 to strengthen the credit mechanisms, the reference on p. 11 to "the ESCB taking a view on the exchange rates of the Community vis-à-vis major third currencies" and the idea on p. 12 that the ESCB, together with representatives of national central banks, should represent the Community in international meetings.

The Chairman asked all those who had drafting suggestions to send them to the Rapporteurs by 20th January 1989.

(c) Discussion on Stages II and III

The exchange of views on the Stages II and III were relatively brief and rather general. Basically two views were expressed: Pöhl favoured to concentrate on Stage I and not to elaborate very much on subsequent stages, especially since the main elements of Stage III would be covered in Part II of the report. In particular, he warned of making unrealistic recommendations on institutional requirements in the non-monetary field; rather, the report should suggest to work on the basis of existing institutions. Pöhl, however, also said that he was willing to consider giving in Stage II the ESCB the right to intervene in exchange markets against third currencies and to set general targets for monetary policy. This view came closer to the views held by de Larosière (and others) who felt that a general and vague description of Stages II and III was insufficient, especially if Stage I did not contain institutional changes. If institutional changes were made only in Stage II, it would have to contain some of the features of the ERF proposal and, moreover, Stage II would have to spell out the nature and the main characteristics of the process of monetary integration that would finally allow to enter Stage III. In addition, the question of parallelism would have to be discussed.

2. Issues relating to the ECU

Against a background of papers prepared by Ciampi, Duisenberg, Lamfalussy and Pöhl, the Committee touched on the following issues:

(a) Need for a single currency

It was generally accepted that in the final stage the national currencies could eventually be replaced by a single currency. This currency should be the ECU and there was broad support for Duisenberg's idea to recommend to the European Council to declare officially that the future money of a European monetary union should be the ECU. Boyer pointed out that there was a question of how to introduce one currency in the final stage and Doyle expressed concern that a changeover to a single currency could - because of upward rounding when converting prices into a new currency unit - result in a one-off inflationary push.

(b) Parallel currency approach

The Committee rejected the idea of a parallel currency concept, apparently for the reasons given in Duisenberg's and Pöhl's paper.

(c) Link between the official and the private ECU

Pöhl (and in his paper, Duisenberg) rejected the idea of a link between the official and the private ECU. The reasons given were that such a link implied money creation and that a link was therefore not conceivable as long as the responsibilities and powers of a European monetary institution issuing ECUs had not been defined. Without a European central bank in place and in charge of the control of the private ECU, a link would mean that national central banks were responsible for the currencies of other national central banks.

(d) The ECU as a numeraire for private transactions and its role in promoting monetary union

The Committee agreed that the ECU's basket definition should be maintained and that all remaining restrictions on its use in private markets should be lifted. However, there appeared to be scepticism whether the ECU would play a significant role in promoting monetary integration.

(e) The ECU as a monetary policy instrument

Ciampi's proposal to use the ECU as an instrument to conduct a common monetary policy (towards the end of Stage II or in Stage III) met

with some reservations, though most Committee members considered it as one possibility for organising a common monetary policy. It was also mentioned that the proposal correctly identified the core problem, i.e. that a central institution had to decide how much money and credit was to be created in order to support economic activity in a non-inflationary environment. The main comments were as follows:

- the proposal was modelled on a monetary base control concept, but in contrast to similar existing systems which operated in the context of profit-oriented commercial banks, it was questionable whether the scheme could work linking only official institutions whose decisions were not governed by profit motives; this interpretation was, however, rejected by Thygesen who argued that the proposed scheme should be compared with a gold standard system;
- the proposed scheme was too rigid and, if introduced at a time when exchange rates were still adjustable, central banks could lose the freedom to defend exchange rates;
- the scheme would probably imply the use of monetary base control at the national level; however, this approach relied on stable relationships between the monetary base and wider monetary aggregates and key economic variables; experience had shown that these relationships were not sufficiently stable; moreover, monetary base control was going out of fashion even in those countries that had used this method.

3. Organisational matters

There was a brief discussion of the future role of the Committee. In general agreement was expressed that the Committee's existence should come to an end with the completion of the report and that any follow-up work should be made in the appropriate Community bodies. However, questions of interpretation of the report might be raised after a political decision in favour of implementing economic and monetary union had been taken and some arrangement or understanding might be needed on who would answer such questions.

The Chairman suggested a final meeting of the Committee after the European Council in June. The purpose of this final meeting would be to brief the Committee on the European Council's reactions to the report.

As far as the future work programme was concerned, it was agreed that the February meeting should be devoted to a discussion of the revised Part II of the report, as well as to a more profound exchange of views on regional policy, monetary policy in a situation of permanently fixed exchange rates, issues relating to the ECU and macro-fiscal policy. Short notes on all these issues would be distributed in advance of the meeting. A full draft of the report would be submitted to the Committee before the meeting in March and, in the light of the discussions, the Rapporteurs would then revise the draft report, which would be finalised at the Committee's meeting in April.