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MINUTES*

OF THE 242nd MEETING OF THE COMMITTEE OF GOVERNORS

OF THE CENTRAL BANKS OF THE MEMBER STATES

OF THE EUROPEAN ECONOMIC COMMUNITY

HELD IN BASLE ON TUESDAY, 13th FEBRUARY 1990 AT 9.30 a.m.

Those present at the meeting were: the President of the Deutsche Bundesbank and Chairman of the Committee, Mr. Pöhl, accompanied by Mr. Tietmeyer and Mr. Rieke; the Governor of the Banque Nationale de Belgique, Mr. Verplaetse, accompanied by Mr. Rey, Mr. Michielsen and Mrs. de Wachter; the Governor of Danmarks Nationalbank, Mr. Hoffmeyer, accompanied by Mr. Mikkelsen; the Governor of the Bank of Greece, Mr. Chalikias, accompanied by Mr. Papademos and Mr. Karamouzis; the Governor of the Banco de España, Mr. Rubio, accompanied by Mr. Linde and Mr. Durán; the Governor of the Banque de France, Mr. de Larosière, accompanied by Mr. Lagayette and Mr. Cappanera; the Governor of the Central Bank of Ireland, Mr. Doyle, accompanied by Mr. O'Grady Walshe and Mr. Reynolds; the Governor of the Banca d'Italia, Mr. Ciampi, accompanied by Mr. Santini; the President of De Nederlandsche Bank, Mr. Duisenberg, accompanied by Mr. Szász and Mr. Benard; the Governor of the Banco de Portugal, Mr. Tavares Moreira, accompanied by Mr. Amorim; the Governor of the Bank of England, Mr. Leigh-Pemberton, accompanied by Mr. Crockett and Mr. Price; the Vice-President of the Commission of the European Communities, Mr. Christophersen, accompanied by Mr. Pons; the Director General of the Luxembourg Monetary Institute, Mr. Jaans. Also present at the meeting was Mr. Dalgaard, Chairman of the Group of Experts. The Secretary General of the Committee, Mr. Morelli, his Deputy, Mr. Bascoul, and Mr. Scheller also attended.

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* Final text approved at the meeting on 13th March 1990, which incorporates some drafting changes.

I. Approval of the minutes of the 241st meeting

The Committee approved the minutes of the 241st meeting on the understanding that the editorial amendments suggested would be incorporated in the final text.

II. Monitoring of economic and monetary developments and policies in the EEC based on:

- Preparation by the "Dalgaard Group" and discussion by the Committee of Alternates;
- Statistical charts and tables

A. Statement by Mr. Dalgaard

The dollar had been influenced by a number of factors, particularly political factors, which had resulted in a high degree of volatility but little net change in the exchange rate since the beginning of January 1990. The dollar's current level was regarded as acceptable and reasonable by the experts, who had noted the continuing deterioration in the US current account since the second quarter of 1989.

Within the EMS, the typical development after a realignment had been observed, i.e. the high interest rate currencies had strengthened while the low interest rate currencies had weakened. The narrowing of the margin for the Italian lira had been a very special realignment, for, except in the case of Italy, there had been no outflow of capital prior to the operation and no change in market exchange rates, but a further realignment in the near future was now no longer expected.

The Italian lira had been firm and close to the top of the narrow band. Short-term interest rates had risen for exceptional reasons: an unexpected budget cash surplus, combined with the Government's programmed borrowing, had led to a tightening of liquidity. Long-term interest rates had not been affected by the moderate increase in short-term rates. Substantial intervention purchases had taken place, amounting to approximately US$ 3 billion during the four weeks following the realignment; this compared with sales of US$ 6.6 billion between October 1989 and the beginning of January 1990. Since the beginning of February intervention had come to a halt, mainly because the lira had been allowed to move closer to the 2.25% limit and the interest rate differentials in favour of the lira had narrowed.

The French franc had been relatively firm. The approach adopted by the authorities had been a textbook example of how to behave: they had allowed the exchange rate to strengthen and interest rates to decline, and there had been some intervention.

Developments in eastern Europe, particularly in the German Democratic Republic, had had a marked influence on the markets. There were, for example expectations of stronger growth in the Federal Republic of Germany and an increase in government expenditure, which in turn would result in higher interest rates because:

- either inflationary pressures would lead the Bundesbank to tighten its monetary policy,
- or increased government expenditure would be financed via increased borrowing on the capital market.

As a result of these expectations bond yields had already been rising strongly, by about 1 percentage point since early January, half of this increase having occurred within one week following the Federal Republic's offer of monetary union with the GDR.

The rise in German long-term interest rates had been followed in a number of EEC countries, particularly the Netherlands, Belgium and Denmark, to a lesser degree in France, Ireland and the United Kingdom, but not at all in Spain and Italy. Since prices had so far not increased to the same extent, real interest rates had risen further and now stood at around 6.5% in the Netherlands, for instance.

Developments in the GDR, and in eastern Europe generally, would undoubtedly be the major influence on the foreign exchange and capital markets in the coming months. So far the net effect on exchange rates had been moderate because inflationary fears had been neutralised by higher interest rates. Nevertheless, the Deutsche Mark had shown stronger movements than usual in relation to the other ERM currencies.

On the whole, the situation within the EMS had been quiet and free of tension. The narrow band had remained around 2% and interventions had been reasonable, involving mainly purchases by the Banca d'Italia and the Banque de France. These purchases had been concentrated on the Deutsche Mark, although the Banca d'Italia had also purchased ecus and smaller amounts of French francs, Belgian francs and Danish kroner.

B. Statement by Mr. Rey

In a fairly brief exchange of views the Alternates had drawn attention to three areas of interest.

1. With regard to the situation in the individual Community countries, the following points should be noted:

- in Germany, real GDP growth in 1989 would seem to have been over 4% according to the latest revisions. In addition, the seasonally adjusted trade surplus showed a downward trend on the basis of figures for the four quarters of 1989;
- in France, the measures to liberalise exchange controls had continued to exert a positive effect, as had been expected;
- in Italy, the rise in short-term interest rates, while the Italian lira was at the top of the EMS band, was attributable to seasonal and temporary factors. Lending to the private sector was still increasing sharply. The return flow of capital after the realignment had not been abnormally large.

2. Despite its day-to-day volatility, the level of the US dollar was not a source of concern for the moment. The same could not be said of the yen, however, and its behaviour should be watched very closely after the elections in Japan.

3. The Alternates had briefly discussed the development of long-term interest rates, which had risen and in some cases caught up with short-term rates. This development could be interpreted in a number of ways, and in particular it raised the question of the potential effects for the real economy.

Long-term interest rate expectations were clearly affected by developments in eastern Europe. The German Alternate had, however, pointed to the fact that the markets might be influenced by estimates of the transfer of resources needed for the GDR and the real impact on the budget of the Federal Republic which were clearly excessive and overlooked important offsetting factors. Nevertheless, the rise in long-term interest rates did reflect the prevailing uncertainty.

C. Discussion by the Committee

Mr. Ciampi agreed that the narrowing of the Italian lira's margin in January had not been a true realignment, since only the central rate had been lowered leaving the lower intervention limit of the fluctuation band unchanged at the level fixed in the general realignment of January 1987. After the operation the lira had appreciated on the markets and inflows of foreign exchange had been recorded, offsetting the outflows that had occurred during the preceding two months. The Italian interest rate situation had been unusual in January. In Italy liquidity was very dependent on the central government borrowing requirement, which was not spread evenly over the year. This requirement led to money creation and for most of the year the Banca d'Italia continually had to absorb liquidity. For two months, however, the situation was quite the reverse: in June there was a marked budget cash surplus and in January normally a balanced position. This year, in January, there had been a surplus and the banks had suffered a severe liquidity shortage, especially as at the end of the month the central bank called in the compulsory reserves which the commercial banks had to place with it. The Banca d'Italia had therefore entered into repurchase agreements, for about US$ 12 billion, but this operation had not prevented an increase in interbank interest rates. On the other hand, the rate on three-month Treasury bills, which had been issued on three occasions in January, had declined by approximately 1 percentage point, which clearly showed that movements in short-term interest rates in January had been paradoxical.

Mr. Duisenberg referred to the mention of very high real interest rates in the Netherlands, viz. 6.5%, resulting from an 8.5% bond rate and a 2% inflation rate. Indeed, this was attracting criticism and there was pressure for the central bank to bring rates down, which it opposed so as not to contribute to a resurgence of inflation. It appeared, however, that the concept of real interest rates was used excessively and was perhaps too simplistic. In the Netherlands foreign trade accounted for 50% of GDP, so that the consumer price index was not really a valid indicator. For instance, export prices had risen by 6% in 1989, which meant that the real interest rate for exports had been only 2.5%. Producer prices were therefore a better measure of real interest rates. In future it would be useful to take a closer look at this delicate concept and refine it so as to avoid presenting somewhat crude indicators and giving rise to misunderstandings.

Mr. Hoffmeyer observed that the movement in long-term interest rates, which had been triggered principally by events in Germany, was the result of market responses and expectations. The central banks could do nothing in this connection. However, the very concept of the real interest rate was difficult, and indeed open to some criticism, and it had to be handled carefully.

The Chairman made some remarks on the German situation. The fears concerning the monetary implications of the political developments had been exaggerated. The German economy was prosperous enough to finance the transfers to the GDR; in 1989 the Federal Republic had exported more than DM 100 billion of capital and even if the budget deficit were to worsen the capital market would be able to cope. The anticipated rise in interest rates had already occurred and a certain levelling-off might be expected. In any event, an increase in interest rates was quite natural given the volume of the resources that would have to be transferred to the eastern European countries; furthermore, it should make it possible to control the exchange rate in Germany and hold it steady. So far, the political developments had not placed any pressure on the dollar/DM rate and the Deutsche Mark was fairly firm, but if pressures did arise the Bundesbank would respond and Germany's partners would then be affected.

Underlying inflation was certainly higher in the Federal Republic at present than suggested by the consumer price index (+2.6%). Domestic demand was very buoyant, and if it increased further with the GDR this could very quickly lead to overheating. High interest rates were therefore useful at present and the rate structure had become more normal. However, the exchange rate could become the main problem.

Mr. de Larosière stated that a certain amount of caution was necessary. Signs of a slowdown in activity were emerging in European countries, in particular the United Kingdom, and outside Europe, for example in the United States. In France inventories had been rising for two or three months and the inflow of orders had slackened. If these signs were confirmed as a real international trend, great attention would have to be paid to the contagious effect of higher interest rates in Germany. The European economies were very open and within the EMS exchange rate mechanism influences were transmitted very readily. It was therefore necessary not to be too complacent about interest rate movements in the Federal Republic, for even if they were justified in that country there was a risk that they could affect economies where activity was weakening.

The Chairman emphasised that in the Federal Republic the risk was not of a slowdown in activity but of overheating, especially with the addition of strong demand from the GDR. The markets and some operators also feared an upsurge of inflation. Some slackening of demand in Europe would therefore be welcome from the German point of view. Furthermore, a certain shift in the Federal Republic's exports would be desirable, otherwise it was difficult to see how a large surplus with the eastern European countries could be added to the substantial trade surplus with the West (approximately DM 150 billion). Against this background the present level of German interest rates, which had been imposed by the markets, was reasonably appropriate and would enable exchange rates within the EMS and vis-à-vis the dollar to be stabilised. Opinions on this subject seemed, however, to differ within the Committee and the problem could be discussed again in March.

Mr. Doyle pointed out that indeed the recent development of interest rates in the Federal Republic was no doubt satisfactory for that country but not, for example, for Ireland. A slowdown in demand in the Federal Republic was perhaps desirable and necessary in the present circumstances; however, it was quite inappropriate in Ireland, where for years demand had declined and the present recovery should not be jeopardised by high real interest rates. It was disturbing to see that, as a result in particular of the international integration of the financial markets, the effects of a monetary union were out of phase with the development of economic union. There was therefore a considerable risk that monetary union would accelerate while economic union lagged behind.

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 January and the first few days of February 1990

The Chairman took note of the Committee's adoption of the "concertation report", which would be sent to the EEC Ministers of Finance in the usual way.

IV. Examination of Report No. 68 prepared by the group of experts chaired by Mr. Dalgaard on issues raised by a possible association of third countries with the EMS

A. Statement by Mr. Dalgaard

The possibility of association with the EMS was provided for in the European Council Resolution of December 1978. Since then important developments had taken place within the Community, in particular the

Basle/Nyborg Agreement, the integration of financial markets and the decision to establish economic and monetary union. The association of third countries with the EMS was therefore a highly political question, on which the experts had not adopted a position. Certain points had, however, been made. For example:

- it was important to safeguard the credibility and stability of the EMS;
- associate members should not be allowed to participate in the decision-making process.

The main advantage of association for the Community would lie in extending the zone of exchange rate stability, but there would be a risk of more frequent realignments, which would undermine stability.

The experts considered that close ties with the Community should not be the sole criterion for admitting an associate member but that further conditions should be met, such as those set out on page 5 of Report No. 68, namely a sound economy, a stability-oriented general economic policy and the absence of exchange controls or a commitment to abolishing them rapidly.

Association with the EMS could be more or less far-reaching and range from a minimalist to a maximalist approach. The difference would lie in particular in the degree of consultation foreseen.

The experts had also examined technical and practical questions. Notwithstanding the wording of the European Council Resolution, association could not be based solely on an agreement between central banks. The decision to admit associate members, to fix their opening central rates and possibly change them later, should be governed by the same procedure as realignments, i.e. it should rest with the Ministers of Finance and the central bank Governors.

A number of practical aspects of association, described in detail in the report, would require decisions to be taken but did not raise any major problems. The same applied to the legal aspects.

B. Statement by Mr. Rey

The discussion by the Alternates could be summarised as follows:

1. The Alternates had unanimously stressed that Report No. 68, which analysed in depth all the points to be taken into consideration in the context of a possible association of third countries with the EMS, was an excellent document.

2. The Alternates had recognised that there were a number of reasons for considering the issue of association sympathetically: the association of third countries was contemplated in the European Council Resolution establishing the EMS; a move towards stricter exchange rate discipline and stability-oriented policies could be discerned in Europe over the last few years and the Community should avoid giving the impression of being inward-looking.

However, sensitivity to the risks which might arise from the formal association of third countries varied. Many Alternates felt that the risks did not outweigh the expected benefits and should therefore not prevent the Community from expressing a general attitude in favour of association, provided that the criteria for eligibility were properly defined (the suggestions made in that respect on page 5 of Report No. 68 had been considered appropriate). Once a country was recognised as eligible, there was enough flexibility in the technical linkages proposed in the experts' report to accommodate the preferences of the Community central banks; some of them had already expressed a preference for arrangements close to what was referred to as the "minimalist" approach, at least initially.

Other Alternates, however, had stressed the need for great caution in approaching the issue of association at the present juncture. They felt that it would be unwise to encourage potential candidates to apply for association unless they were ready to accept all the conditions which full EMS membership implied, and this was hardly consistent with the minimalist approach.

It had also been stressed that at some point the attention of the Ministers of Finance should be drawn to the fact that association with the EMS entailed more than mere technical matters.

3. As far as the follow-up was concerned, the Alternates had felt that in view of the importance of the question of association the Governors should comment not so much on the technical and practical aspects as on matters of a more general nature. Accordingly, the Committee of Governors should express its views on association to the Ministers of Finance in good time. However, the Governors might wish to await the outcome of the discussions which the Monetary Committee might shortly be holding on the question. The Dalgaard Group's Report should meanwhile be kept as an internal Committee of Governors document.

C. Discussion by the Committee

Mr. de Larosière considered that the idea of partial or "minimalist" association with the EMS might have been meaningful ten or perhaps five years ago, but now if association took place it had to be total. A "minimal" association, i.e. without a commitment on the part of the associate countries regarding co-ordination of their economic and monetary policies, and involving only participation in the machinery for exchange rate fluctuation and stability within the margin, did not make much sense. Furthermore, such an association would introduce an element of instability into the EMS, particularly as regards realignments, without the advantage of closer economic and monetary integration. The idea of a minimal association ran counter to what the Governors were endeavouring to achieve within the framework of their Committee. Moreover, experience had shown that exchange rate stability was not really complete and significant unless it was based on convergence of the fundamentals. To offer certain countries the opportunity to participate in exchange rate stability without full participation in the commitments, responsibilities, rights and obligations arising from the system, made no real sense. It was therefore necessary to approach this question with great caution and not to extol, for political reasons, the benefits of what would simply be association "on the cheap".

Mr. Christophersen thanked the Committee for the work it had done on the subject of association with the EMS, which was a very delicate matter politically. Informal representations had already been made, in particular by Austria, for which this was a logical consequence of its application to join the Community, and also by the Norwegian and Swedish Governments. In the past few weeks the Swedish and Norwegian Prime Ministers had visited the Commission: the former had not expressed any formal desire for association but a certain interest and the intention of following closely the outcome of any application by Norway. The Norwegian Prime Minister had noted the broad political consensus in his country in favour of early association; this was seen in the context of the negotiation of an agreement on wider co-operation between the EEC and EFTA and also as a way of establishing a closer relationship with the EEC with a view to a possible membership application at a later date. It was highly probable that during the next election campaign in Norway, in 1992, accession to the Community would be a major issue. The Commission had stated clearly to the Norwegian Prime Minister that the situation had changed considerably since the creation of the EMS in 1979, particularly now, with the launching of Economic and Monetary Union. Right from Stage One of EMU, the associated countries would have to commit themselves to economic convergence and submit to the same disciplines as the Member States with regard to the co-ordination of macro-economic and monetary policies. With the transition to Stage Two it would be much more difficult to envisage association, as policy co-ordination would then be subject to binding decisions which the associate members would have to accept without participating in the decision-making process or the institutions. Therefore, because of EMU, the countries concerned would have to decide whether they saw association as a step towards a wider commitment leading to accession to the Community. If this was not the case, it would be very difficult, and virtually impossible in a few years' time, to combine association with progress towards Economic and Monetary Union. The Norwegian Government had taken note of this message and intended to consider the matter and its position: it appeared, however, to be keenly interested in association as a step in the process of preparing public opinion and politicians for an application to join the Community.

Mr. Christophersen added that the subject of association with the EMS could be raised at the next informal ECOFIN Council meeting, due to be held at the end of March in Ireland.

Mr. Duisenberg expressed his appreciation of the excellent report by the experts and observed that two different attitudes were discernible among the Governors. One advocated caution with regard to association, which it thought would complicate the process of monetary integration. The other, which was Mr. Duisenberg's own, viewed association positively, provided that the preconditions were met. The experts' report had clearly set out those conditions, namely a sound economy, a stability-oriented policy and the absence of exchange controls or a timetable for their abolition. In addition, associate members would have to accept the technical principles relating to the exchange rate mechanism that were contained in the Basle/Nyborg Agreement. On this basis association would have advantages. The positive nature of the discipline imposed by the EMS was increasingly recognised worldwide, and it was therefore in the general interest as well as that of the Community to accept associate members and increase the number of inter-dependent countries practising exchange rate stability. It was also desirable that the Community should not be inward-looking. Co-operation was of course bound to be closer and more formal among the Member States than with associate countries, but co-operation with those countries could be conducted on a pragmatic basis. For example, in the case of realignments, where experience showed that the negotiations were conducted essentially on a bilateral basis, pragmatic participation of associate members was conceivable; they might also be involved periodically in the Governors' discussions and perhaps gradually in the policy recommendations.

Mr. Ciampi acknowledged that the EEC was an open community but stressed that the EMS was not just a technical affair. Exchange rate policy very much overlapped with monetary policy and the Committee had emphasised many times the need to co-ordinate all aspects of economic policy. Anything which ran counter to that approach and to the choice already made was thus unacceptable, and association with the EMS which would have such adverse effects was therefore also unacceptable.

Mr. Duisenberg pointed out that, to take the case of Austria, here was in effect a unilateral member of the EMS, whose policy was framed accordingly. Furthermore, Austria had applied for membership of the Community and it would therefore be logical to give it the opportunity of association with the EMS as an intermediate step pending full membership.

Mr. Jaans concurred with Mr. Duisenberg and, referring to the remarks made by Mr. de Larosière and Mr. Ciampi, agreed that at the present juncture there was really no minimalist approach to association. The selection criteria put forward by the experts already avoided that approach. In addition, current Community legislation, which would perhaps not be very easy to change now, permitted a close association with third countries. On the other hand, if the argument was taken too far any association would be impossible prior to membership of the Community, which would make the Community appear terribly inward-looking. Lastly, if a fourth condition, namely a probation period, were to be added to the three conditions listed by the experts for association, Austria had already successfully completed such a period.

Mr. Hoffmeyer agreed with Mr. Duisenberg and Mr. Jaans. The decision in 1978 to open the EMS to outsiders had reflected not simply a desire to be nice to Norway but also the idea of an advantage for the Community. It had to be acknowledged that it was in the interest of the Community that the outside area should be stable; if care was taken to ensure that Economic and Monetary Union was not adversely affected, the association of third countries with the EMS would be beneficial to the Community and respect the open-door approach.

Mr. Christophersen observed that the decision to establish an economic and monetary union radically changed the situation compared with 1979. The transition from Stage One to Stage Two would mean that far greater discipline would be required of members and that the decisions would be binding not only in the monetary but also in the economic field, where the Ministers of Finance would be able to take decisions. Prospective associate members therefore had to realise that they would have to undertake to abide by such decisions and that the situation would be accentuated with the transition to Stage Three. Then, there would be more Community decisions, taken by a majority, and the associate members would not participate in them. The kind of association envisaged in 1978 would therefore probably no longer exist in a few years' time, but of course the situation would be very different if an applicant, such as Norway, were to state that its long-term strategy was perfectly consistent with that prospect and was aimed at full participation in the Community.

Mr. Doyle pointed out that it would be useful to make it clear whether what was being discussed was association with the EMS or only with the exchange rate mechanism, which was a narrower concept. It was questionable whether it was wise to move towards a situation in which associate members would participate in discussions on realignments and would have greater influence on the operation of the exchange rate mechanism than, for example, the United Kingdom, which was a member of the Community. There was a risk of an odd situation being created with three categories of member: full members of the EEC which accepted all the obligations, including those arising from the exchange rate mechanism; EEC members which did not participate in the exchange rate mechanism; and, finally, associate members which, inadvertently or deliberately, might be responsible for realignments, even though they were not members of the EEC. Such a possibility presented a real danger and needed to be examined carefully.

The Chairman agreed that a clear distinction had to be made between the issues involved. Firstly, there was the problem of whether the Community should accept new full members, which would therefore participate in the decision-making process. This was a political matter which lay outside the Governors' competence. It was, however, within their competence to decide whether to accept third countries in the EMS exchange rate mechanism. That had been the original concept in the case of the "snake", for instance, and certainly also when the EMS was set up. There was, moreover, the question of whether the exchange rate mechanism was really a Community institution: legally, except for fixing the exchange rate and the realignments, everything could be dealt with by the Governors within the framework of the Agreement between central banks. The association of third countries raised the question of the ability of such countries to maintain stable exchange rates with the Community currencies in the exchange rate mechanism and therefore also raised the major problem of realignments and policy adjustments that might be brought about by associate members but not desired by the full members. In that connection, it had to be acknowledged that Austria had shown that it was possible to maintain a very stable exchange rate without being a member of the EMS. It also had to be acknowledged that the scope of the EMS went much further than the exchange rate mechanism.

It would therefore be useful to consider the kind of relations which could be envisaged with countries such as Austria, Norway or Sweden, and the Alternates and experts could study this matter again.

Mr. Rey said that the Alternates were prepared to continue the work. The problem of the realignment procedures could be settled very pragmatically but the really difficult problem was that of the level of commitment of associate members to convergence of economic policies with the member countries.

The Chairman observed that Austria would not present such a problem if it continued the policy it had been following for a number of years, but the situation might be different with Norway.

In reply to a question from Mr. Duisenberg, Mr. Christophersen pointed out that Austria and Norway would be pressing the Community to define its position soon and that the informal ECOFIN Council meeting at the end of March would perhaps be a good opportunity to discuss this subject.

Mr. de Larosière felt that the applicant country's degree of "closeness" to the EEC and its objectives should be an important factor when considering association. In this connection, it might be noted that Austria had applied for accession, which Norway had not, and that it had shown during a de facto probation period that it was perfectly in line with the Community's objectives of convergence and stability. This clearly showed that association had a dimension other than the strictly legal one.

Mr. Jaans thought that if the Ministers had to debate association they could wait until the Governors had already examined the technical implications and adverse effects, if any, of association with certain countries. The question could not be deferred on the pretext of uncertainty and the Governors should analyse the potential risks and benefits entailed in association.

The Chairman noted that there was general agreement in favour of enlarging the stable exchange rate area and said that he would be in favour of Austria becoming an associate member of the EMS, with the corresponding rights and obligations. The optimum solution would of course be for Austria to become first a member of the Community, then of the EMS, and finally of the exchange rate mechanism. To proceed the other way round would perhaps not be too difficult in the case of Austria but might be a problem in the case of other countries. While it ought to be fairly easy to define the technical and legal preconditions for association, it would be more difficult to draw up a recommendation for the Ministers, for, with the prospect of Economic and Monetary Union, it was hard to see how a country could be simply associated with the exchange rate mechanism without participating in the decision-making and co-ordination procedures existing within the Community.

Mr. Rubio stressed that it was very important to know what the applicant countries' central banks were prepared to accept in terms of association. It was difficult to study this question if it was unclear what the applicant countries were really aiming for.

Mr. Dalgaard explained that there had been contacts with representatives of the central banks concerned, in particular with Norges Bank, which seemed interested in any form of association and was seeking to establish closer relations with the institutions and systems of the Community. In that case, access to very short-term financing was probably not a crucial factor.

Mr. de Larosière said that if association were to mean that associate members would be able to initiate realignments and use the very short-term financing facility without limit, it was necessary to think carefully before coming to a decision and further information was certainly necessary.

Mr. Hoffmeyer pointed out that if the currencies of the associated countries were not in the ecu, changes in their exchange rates would have less effect on the EEC countries' currencies and might therefore not entail a real general realignment within the EMS. Furthermore, as had been done at the time of the "snake", limits could be set on the use of very short-term financing by associate members.

The Chairman concluded the debate by asking the Alternates to examine in greater detail the problems raised by association with the EMS and noting that there was no urgency.

V. Continuation of the review of the formal rules relating to the official ecu

A. Statement by Mr. Rey

1. The Committee had already discussed this question twice, in December 1989 and January 1990. In January the Governors had reached a general agreement to formalise the acceptance of official ecus in intra-Community settlements up to 100% subject to consensus on the following two points:

- firstly, introducing a supplementary recital in the Instrument modifying the EMS Agreement stipulating that these settlements in ecus should not lead, on a lasting basis, to excessive debtor or creditor positions in ecus resulting in an unbalanced composition of a central bank's reserves;
- secondly, entering in the minutes of the Committee's meeting on the occasion of the signing of the Instrument a statement reaffirming the principles of the Basle/Nyborg Agreement concerning interventions in EMS currencies.

2. Through written procedure, a wording for the additional recital of the Instrument had been approved by all the central banks. On the other hand, the text of the entry in the minutes had not been agreed. Neither a first draft prepared by the Secretariat nor an alternative proposal of the Deutsche Bundesbank had received unanimous agreement.

As the issue was clearly related to the mandate given to the "Monitoring Group" to study some technical aspects of the prior approval required for intra-marginal interventions in Community currencies, Mr. Dalgaard had been asked to report on the state of the Group's discussions. Although the continued disagreement among the experts should not be exaggerated, the discussions had not yet produced a unanimous view. Before the experts resumed their work, the Alternates proposed to have a discussion focusing on the main issues in March with a view to giving some guidance to the experts if possible. Formalising the 100% acceptability of official ecus in settlement was not so urgent that it could not await the results of the discussions in progress.

B. Discussion by the Committee

The Chairman expressed his disappointment at the absence of agreement among the Alternates. The Governors were talking in terms of ambitious objectives for the co-ordination of economic and monetary policies and were not able simply to reaffirm their existing agreements on the rules governing intra-marginal interventions.

Mr. Rubio said that there was no disagreement about adhering to what had previously been accepted, but that there had been certain difficulties, not least in the view of the Banco de España, on which a study had been requested. It would therefore be logical to await the outcome of the work of the "Dalgaard Group" and the conclusions of the Alternates before agreeing to a version of a statement in the minutes that was more rigorous than the first draft submitted.

The Chairman noted that the principle of prior agreement for intra-marginal interventions and the co-ordination of intervention policies were very important to the Deutsche Bundesbank; he accepted the suggestion that the discussions be continued within the "Dalgaard Group", but stressed that the Governors would have to take a decision at some point.

VI. Exchange of views on developments regarding Economic and Monetary Union

Mr. Christophersen gave a brief account of the stage reached in the procedure regarding the Parliament's Opinion on the two Council Decisions concerning co-operation between the central banks and economic convergence. The European Parliament had proposed a whole series of amendments to these texts, but following protracted discussions the Commission hoped to have reached agreement to the effect that only two amendments would be accepted, one for each Decision. The Decision amending the 1964 Decision would take account of the suggestion that the Chairman of the Committee of Governors could be invited to appear before the Parliament on the occasion of the presentation of the Committee's annual report and before the competent parliamentary committee when circumstances so warranted. This formula had already been accepted by the Governors, and the Chairman could always reply to such an invitation as he wished. The Parliament had also proposed broadening the objectives to be pursued by the Committee of Governors to include, in particular, non-inflationary growth, a high level of employment and external equilibrium. The Commission had pointed out that any such formula was premature and that it was necessary to wait and see what form the second stage of Economic and Monetary Union would take; the Parliament had accepted this standpoint.

Concerning the Decision on convergence, an amendment similar to that for the 1964 Decision would be accepted, viz. the President of the ECOFIN Council could be invited to appear before the competent committee of the European Parliament whenever the Council had issued policy recommendations.

To conclude, the European Parliament would be submitting its Opinion shortly, so that the ECOFIN Council might adopt the two Decisions at its March meeting.

The Chairman thought that it was indeed in the interests of the Governors to accept a procedure or forum in which the Committee could express its views.

Mr. Rey pointed out that a draft of the Committee's new Rules of Procedure had been submitted, by written procedure, to the Alternates, who were shortly to discuss it and agree on a text to be submitted to the Governors.

The Chairman took note of this information and said that it was right to enshrine already defined positions and modifications in Rules of Procedure, but that it was necessary to await formal adoption of the Council Decision on co-operation between the central banks.

VII. Exchange of views on a proposed liquidity facility for the private ecu clearing and settlement system

A. Statement by Mr. Rey

The Alternates had had a brief exchange of views on the recent projects to establish a liquidity facility to ensure the smooth functioning of the private ecu clearing system. Proposals regarding such a facility were described in notes put forward by the Bank of England and the Banque de France. However, some Alternates had felt that it was not possible to take a position on these proposals until they could be studied in further detail. Consideration should be given to the following questions in particular:

- whether there was, in fact, a requirement for such a liquidity facility;
- if so, what would be the best mechanism to satisfy that need;
- to what extent were the proposals submitted consistent with the original guidelines agreed by the Governors in March 1983;
- whether such a facility would have any adverse repercussions on the monetary policies of Community member countries.

The Alternates had agreed that the "Dalgaard Group" should be asked to examine these questions and to present its report probably for the March meeting.

B. Discussion by the Committee

Mr. Leigh-Pemberton stated that the Bank of England's proposal was a response to a request made by the Ecu Banking Association. The EBA had been asked by the Governors to increase the number of clearing banks, and it had done so, with certain reservations, fearing that this would place a burden on the system. The proposed liquidity facility would make it possible to alleviate the concern felt by the system's members; it did not need the formal approval of the Committee of Governors as it was a project which essentially concerned the clearing banks and the BIS in its capacity as Agent for the system. It was natural, however, that the Governors should discuss it and be able to express their views. The purpose of the proposed facility was to assist the operation of the clearing system and to ensure that a lack of counterparties among participating banks would not result in the suspension of clearing and settlement. The Bank of England considered that the facility which it was proposing should not be the only one, and other central banks could also make proposals.

The Alternates' suggestion that the projects put forward should be studied in further detail was acceptable but it should not cause too much delay.

Mr. de Larosière shared Mr. Leigh-Pemberton's view; he pointed out that the Banque de France had also been in contact with banks which held ecu deposits with it and which were interested in a facility. This facility was not intended to stand in opposition to or delay the Bank of England's proposal but to offer rather different, and perhaps complementary, assistance. The first informal contacts with the BIS had shown that it would have no problems with the Banque de France's project.

Mr. Leigh-Pemberton said that he also wished to be able to advance in the discussions with the BIS, clarify the situation within the Committee at the next meeting in March, and be able to put a mechanism in place as soon as possible.

Mr. Duisenberg, in his capacity as President of the BIS, added that the Bank's original mandate to take no risks in the private ecu clearing system would be respected with the mechanisms proposed by the Bank of England and the Banque de France.

The Chairman noted that from a legal point of view any steps taken by the BIS in its role as Agent for the clearing system required formal approval. Moreover, the "Dalgaard Group" should examine the question in substance, bearing in mind in particular that when the system had been set up the central banks had decided that neither they nor the BIS should act or be seen as ecu lender of last resort.

VIII. Other matters falling within the competence of the Committee

1. Allocation of the expenses of the Committee's Secretariat for 1989

Mr. Rey said that the Alternates had no comment to make regarding the expenses of the Secretariat of the Committee of Governors, the Board of Governors of the European Monetary Co-operation Fund and the EMCF Agent.

The Chairman noted the Committee's approval of the expenses as set out in the Secretariat's note given to the members.

2. Formalisation of the Banking Supervisory Sub-Committee of the Committee of Governors

The Committee expressed its agreement with the declaration below concerning the creation of the Banking Supervisory Sub-Committee.

"In accordance with the recommendations for Stage One contained in the Report on Economic and Monetary Union in the European Community, the Committee of Governors of the Central Banks of the EEC Member States has set up a Sub-Committee which shall meet regularly to discuss matters of policy which have implications for the Community in the area of prudential banking supervision and for the execution of banking supervision where there is a Community-wide dimension. The Sub-Committee shall be composed of a senior representative of each EEC central bank and of the Luxembourg Monetary Institute. In those cases in which an EEC central bank is not directly responsible for such matters, a senior representative of the respective banking supervisory authority shall also be invited to participate in the meetings. The Director General of the Financial Institutions and Company Law Directorate of the Commission of the European Communities may also be invited to attend on particular occasions. The Sub-Committee shall report regularly on its activities to the Governors. The Chairman of the Sub-Committee shall be appointed by the Committee of Governors; the first Chairman will be Mr. Brian Quinn, an Executive Director of the Bank of England. The administrative services of the Secretariat of the Committee of Governors shall be available to the Sub-Committee on a regular basis."

3. Press communiqué

The Chairman said that, in view of the unrest on the markets and the political uncertainties, it seemed prudent to send a message making it clear in particular that developments in eastern Europe were not negatively affecting the Committee's work, which was, on the contrary, being intensified so as to strengthen monetary co-operation and the co-ordination of the central banks' policies.

The Chairman had a draft press communiqué distributed during the meeting; the text, a copy of which is attached, was slightly modified following remarks by the Governors; it would be presented to the press and commented on by the Chairman.

IX. Date and place of the next meeting

The Committee's next meeting would be held in Basle on Tuesday, 13th March 1990 at 9.30 a.m.

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

13th February 1990

PRESS COMMUNIQUÉ

At its meeting today the Committee of Governors discussed the recent developments which are taking place in central and eastern Europe and, in particular, in the GDR.

The Governors consider that these events should not be seen as in contradiction with the concept of Economic and Monetary Union within the Community; on the contrary, they believe that a stable and orderly evolution for eastern European countries will be facilitated by a strengthened European Community.

The Committee of Governors has already decided to intensify its contribution to the process of European monetary integration in the framework of its responsibilities. In this context, it should be recalled that the Committee of Governors is working towards establishing a set of commonly agreed and mutually consistent targets and indicators of monetary policies. This initiative is part of the anti-inflationary strategy of Community central banks and their objective of strengthening the co-ordination of monetary policies.