

FROM: N I MACPHERSON (EC1)
DATE: 19 SEPTEMBER 1990

x4443

MISS SIMPSON

cc: PS/Chancellor
PS/FST
Sir P Middleton
Mr Wicks
Mr H P Evans
Mr Odling-Smee
Mr Gray
Mr R I G Allen
Mrs M E Brown
Mr J Grice
Mr McIntyre

POEHL'S PRESS CONFERENCE : 19 SEPTEMBER

*cc Pcs
-pp*

Karl Otto Poehl has today been quoted as saying that "the result [of the Informal Ecofin] was to reject the [British] idea. But unfortunately this was never publicised." See Reuters report attached.

2. This claim is clearly untrue. I suggest the following line to take:

No. Considerable interest in UK proposals; for example, Spain has incorporated hard ecu in their plans for EMU. UK plan remains very much on the table.

3. I will circulate a copy of the Bundesbank paper, which Poehl was launching, tomorrow.

Nick Macpherson

N I MACPHERSON

A Mr Evans Mrs Brown Mr McPherson JS Pes.

HIGH INFLATION COUNTRIES MAY HAVE EMU PROBLEMS X5U0
 FRANKFURT, SEPT 19, REUTER - COUNTRIES WITH HIGH INFLATION
 LEVELS MIGHT FIND IT HARD TO BECOME FULL MEMBERS OF A EUROPEAN
 MONETARY UNION, BUNDESBANK PRESIDENT KARL OTTO POEHL SAID.
 POEHL DECLINED TO SAY WHICH COUNTRIES HE WAS REFERRING TO,
 BUT SPEAKING AT A NEWS CONFERENCE HE SAID, "WITHOUT MENTIONING
 NAMES, CAN A COUNTRY WITH AN INFLATION RATE THREE TIMES THAT OF
 GERMANY PEG ITS CURRENCY TO THE MARK?"
 POEHL ALSO SAID BRITISH PROPOSALS FOR A "HARD ECU" AS A
 PARALLEL TO OTHER EMS CURRENCIES HAD BEEN REJECTED BY ALMOST ALL
 EUROPEAN COUNTRIES AND STOOD LITTLE CHANCE OF SUCCESS.

19-SEP-1245. MON892 BB1903035 MONM

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CONTINUED ON - XSUP

REUTER MONITOR 0622

HIGH INFLATION COUNTRIES MAY HAVE EMU PROBLEMS -PART 2 X5UP
 "THE IDEA THAT WE SUPPORT THE BRITISH POSITION IS WRONG."
 POEHL SAID. "THE CONCEPT OF A PARALLEL CURRENCY HAS BEEN
 REJECTED BY US AND BY ALMOST ALL OTHER COUNTRIES."
 POEHL SAID THE BRITISH PROPOSAL HAD BEEN EXAMINED AT A
 MEETING OF EUROPEAN FINANCE MINISTERS AND CENTRAL BANK CHIEFS IN
 ROME. "THE RESULT WAS TO REJECT THE IDEA, BUT UNFORTUNATELY THIS
 WAS NEVER PUBLICISED," HE SAID.

POEHL SAID THE BUNDESBANK WAS HAPPY WITH ONLY ONE ELEMENT OF
 THE BRITISH PLAN, THE PROPOSAL TO DO AWAY WITH FREQUENT
 REVISIONS IN THE WEIGHTING OF INDIVIDUAL CURRENCIES WITHIN THE
 EUROPEAN CURRENCY UNIT.

19-SEP-1251. MON902 BB1903035 MONM

CONTINUED FROM - X5U0

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CONTINUED ON -- XSVR

REUTER MONITOR 0622

HIGH INFLATION COUNTRIES MAY HAVE EMU PROBLEMS -PART 3 X5VR
 THIS MEANT THE WEIGHTING OF WEAKENING CURRENCIES IN THE
 EUROPEAN MONETARY SYSTEM WOULD BECOME SMALLER, AND THE ECU
 ITSELF WOULD BECOME A HARDER CURRENCY BASKET, HE SAID.
 THE IMPACT OF SUCH A MOVE WOULD BE SYMBOLIC RATHER THAN
 ANYTHING ELSE, HE SAID.

19-SEP-1253. MON910 BB1903035 MONM

CONTINUED FROM - XSUP

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ENDS

REUTER MONITOR 0622

10/2

TELEX-CHEQUER

19/9

19 SEP 1990

DEUTSCHE BUNDESBANK
Presse und Information

TO:	Mrs Brown
FROM:	Frankfurt, im September 1990
SUBJECT:	EST. Sir P. Hilderson Sir T. Burns, Mr Wicks
TO:	Mr H. P. Evans Mr Odling-Smee Mr Scholar, Mr R. L. Allen Mr Gray, Mr A. C. S. Allan Mr Mansfield, Mr Macpherson, Mrs Chaplin

Statement by the Deutsche Bundesbank on the establishment of an Economic and Monetary Union in Europe

- The heads of state and government of the EC member states have decided to establish a European Economic and Monetary Union (EMU) in a multi-stage process. Stage one of EMU started in the middle of this year, and the further stages are to be laid down and the necessary contractual basis is to be created at the intergovernmental conference which is due to meet in December.

The Bundesbank considers it to be its duty to draw attention to the consequences associated with this process, and to point out which conditions must be met if monetary stability is to be assured in future, too.

- The establishment of a Monetary Union signifies the irrevocable fixing of exchange rates between the currencies concerned (with the possibility of their subsequently giving way to a single currency), under conditions of complete, and durably guaranteed, freedom of capital movements. At the same time, this implies the necessity of relinquishing autonomous national domestic and external monetary policies, and of transferring the responsibility for such policies to Community institutions. In this way the participating economies will be inextricably linked to each other, come what may, in the monetary field. The implications of this - especially for the value of money - will depend crucially on economic and financial policy and on the behaviour of management and labour in all member states. They will have to satisfy in full the requirements of an Economic and Monetary Union. In the final analysis, a Monetary Union is thus an irrevocable sworn confraternity - "all for one and one for all" - which, if it is to prove

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endurable, requires, judging from past experience, even closer links in the form of a comprehensive political union.

- III. Economic and economic policy trends in the European Communities are still marked by great differences between the member states. It is true that among some member states - and owing in part to the European Monetary System (EMS) - substantial progress has been made since the beginning of the eighties towards greater convergence in the field of anti-inflation policy, with the Bundesbank having made a major contribution through its policy stance, consistently geared as it is to the stability of the Deutsche Mark. Throughout the EC, however, deep-seated divergences still remain, and in part are actually widening again - divergences which are reflected in particular in the movements of costs and prices, the huge deficits in the national budgets of individual countries, and massive external disequilibria. These divergences are especially pronounced in the case of the United Kingdom, Portugal and Greece (which are not as yet participating in the EMS exchange rate mechanism), and they are likewise unmistakable in the case of Italy and Spain. In the majority of instances, the reasons for this are to be sought not so much in temporary factors as in the considerable differences in institutional structures, economic fundamentals and the attitudes of management and labour.
- IV. Given this economic and economic policy situation in the Community, an early irrevocable fixing of exchange rates and the transfer of monetary policy powers to Community institutions would involve considerable risks to monetary stability, especially for the Federal Republic of Germany. Furthermore, widespread additional calls for compensatory public financial adjustment would be very likely, especially from the countries of Southern Europe, since, in a Monetary Union, these countries would be faced with the unavoidable

consequences of inadequate labour mobility and the continued existence of income and productivity differentials. Although the present situation in a number of member states cannot be compared to the conditions in the GDR, developments there do illustrate the consequences of a Monetary Union under conditions of markedly differing productivity levels.

Particularly at a time when the German economy is being confronted with substantial transitional problems as a result of the intra-German unification process, and when developments in eastern Europe are still unclear in many respects, there is much to be said for preserving such room for manoeuvre and for adjustment as still exists in the field of domestic and external monetary policy and budgetary policy until such time as the economic situation in Germany as a whole and in the European Communities can be regarded as sufficiently consolidated. By then, at all events, the risks inevitably associated with the transition to an Economic and Monetary Union in the EC will be more readily appraisable and presumably also easier to handle. In the meantime, it will be possible to press on resolutely with enhanced efforts to achieve greater convergence in the field of anti-inflation policy throughout the Community, which efforts were initiated upon the commencement of stage one.

- V. In the concrete design of the further stages of EMU, and in determining the institutional structure for the final stage, the Bundesbank regards it as essential that due account should be taken of anti-inflation policy requirements. In particular, it must be ensured that the same stability record can in future be achieved at Community level as has hitherto been registered in the Federal Republic of Germany.

In the view of the Bundesbank, therefore, the contractual safeguarding of the following points is indispensable to the design of the final stage:

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1. The basis of the Monetary Union must be an economic union comprising a common economic area without internal borders, which must also be as open as possible to third countries, as well as an adequate degree of lasting convergence of anti-inflation policy between the member states. An essential feature of the Single Market - besides the free movement of persons (including work permits), goods, services and capital - must be an efficient, market-orientated competitive system (including control of allowances) at Community level.

As far as the Single Market programme is concerned, at present there are still some pronounced deficiencies as regards both decision-making and implementation and, unless these deficiencies are overcome, the elimination of border controls, which is envisaged for 1992, will be in jeopardy. This applies particularly to the harmonisation of indirect taxes, which is regarded as an essential precondition for lifting the border controls.

Another indispensable element of an economic union is adequate commitment on the part of all member states to gearing their financial policies to a lasting anti-inflationary stance. In the long run monetary stability can be achieved and maintained only if, in particular government financial policy in all member states is likewise orientated towards fighting inflation. Since financial policy decisions in EMU will largely remain the hands of the member states, contractual arrangements (including binding rules and sanctions) to ensure effective budgetary discipline in all member states have to be adopted at Community level.

2. In the final stage of the Monetary Union, monetary will have to be formulated uniformly and bindingly at Community level. This can only be done by a Commun

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monetary authority in the form of a European Central Bank System (ECBS), which will have to satisfy the following requirements:

- (a) The ECBS must be able and obligated to give priority in its decisions to pursuing the objective of monetary stability.
- (b) The ECBS must be endowed with durably guaranteed independence in institutional, functional and personal terms. Its members, in the performance of their duties, may not be subject to any instructions or commitments given by other entities, and may not be restricted in their freedom to decide by overly far-reaching reporting requirements either. The principle of equal voting rights for all members is acceptable only if independence of this kind is assured vis-à-vis national influences as well.
- (c) The necessary uniformity of monetary policy-making requires that what have hitherto been national central banks should largely become integral parts of the ECBS, and thus should no longer be able to pursue policies of their own. This is possible only if the national central banks have previously been given the same degree of independence within their respective member states as the ECBS enjoys at Community level and if the monetary policy instruments have been harmonised.
- (d) To guarantee the uniformity of monetary policy on one hand and to take due account of the federative structure of the Community on the other, the ECBS should be given a management structure comprising governing bodies: a Council and an Executive Board.

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The Council should be composed of the Governors of the national central banks and the members of the Executive Board. A sufficiently long term of office (without any possibility of dismissal) and an effectively independent status must be guaranteed for all members of the Council.

The Executive Board should be made up of five to seven members, who are appointed by the European Council by virtue of their experience and ability.

The duties should be divided up between the Council and the Executive Board in such a way that the Council is responsible for setting monetary policy targets and the Executive Board for the necessary decisions of detail and their implementation.

- (e) The ECBS must be endowed with all the instruments necessary for conducting monetary policy. Administrative controls that distort market mechanisms should not be permissible.
- (f) The internal monetary policy of the ECBS must not be hampered by decisions taken in the field of external monetary policy. Hence the ECBS must be given sole responsibility for exchange market intervention, too. In all other decisions affecting external monetary policy - and especially in the event of exchange-rate-policy decisions - the ECBS must be involved in good time and on a basis of co-responsibility.
- (g) The ECBS must not be subject to any obligations to extend credit to public authorities in the Community or in member states.

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3. Because of the far-reaching political implications, the by-laws of the ECBS and the rules on budgetary discipline should be specified in the Treaty, which is subject to ratification by national parliaments and may be amended only with their approval.

VI. In the Bundesbank's view, the economic and institutional conditions for the commencement of the final stage of the Monetary Union and thus for the establishment of the ECBS - which conditions must be met in all member states - can be fulfilled only in the course of a lengthy transitional process. During this process, no institutional changes which result in any curtailment of the freedom of action of national monetary policy may be made.

At the end of the transitional period, the following prerequisites for the commencement of the final stage must be satisfied in the Bundesbank's opinion:

1. The convergence of anti-inflation policy among all the member states participating in the Monetary Union must have progressed so far that
 - inflation has been very largely eliminated in all the countries, and price differences have been virtually stamped out,
 - the budget deficits in all participating countries have been reduced to a level which is tolerable over the longer term and unproblematic in terms of anti-inflation policy, and
 - the durability of the convergence achieved is reflected in the markets' verdict, too, i.e. in a virtual harmonisation of capital market rates.

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2. All the member states taking part in the Monetary Union must previously have participated, without any special arrangements, in the exchange rate mechanism of the EMS for a sufficiently long period, and must have finally dismantled all restrictions on capital movements.
3. Particularly with respect to their commitment to fight inflation and their independence, the by-laws of the national central banks must be harmonised to such an extent that these banks can become an integral part of the ECBS. Such harmonisation also includes an adequate adjustment of their monetary policy instruments.
4. The contractual arrangements (including binding rules and sanctions) for ensuring effective budgetary discipline in all member states must be adopted at Community level.
5. The Single Market programme must have been realised in full, including the dismantling of fiscal border controls.

VII. In order to pave the way, as required, for the transition to the final stage, the following should be provided for in the Bundesbank's view:

1. The efforts already initiated to promote the coordination of monetary policy among the member states, with a view to combating inflation, should be continued and stepped up. At the same time, the monetary policy instruments should be harmonised increasingly. The Committee of EC Central Bank Governors could be transformed into a Council of Governors in due course.
2. In all member states, the by-laws of the central banks should safeguard those banks' independence of

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instructions from political entities, and of the influence of such entities, at an early date.

3. The fiscal policy divergences must be overcome as soon as possible by means of a marked reduction in the budget deficits of a number of member states. The EC Commission and the Ecofin Council should step up their efforts to ensure the observance of adequate budgetary discipline in all member states.
4. The convergence of anti-inflation policy within the Community could also be fostered by a hardening of the ECU through it being contractually stipulated that the ECU cannot be devalued against any Community currency. Such a hardening of the ECU calls neither for the development of a parallel currency nor for the creation of a new institution.

A particularly important point in the Bundesbank's eyes is that the transition to another stage (no matter whether this is a transitional stage or the final stage) should be made solely dependent on the fulfilment of previously defined economic and economic-policy conditions, rather than on specific timetables. Hence the transition to another stage must not be linked to deadlines fixed in advance.

VIII. In the Bundesbank's opinion, the points listed above are indispensable, and not optional, requirements. The Bundesbank considers it necessary for the German delegation to advocate these points vigorously at the intergovernmental conference. The viability of the envisaged strategy for the Economic and Monetary Union must not be endangered in the above-mentioned key respects by the acceptance of compromises during the negotiations. Otherwise, in view of the substantial risks involved, the favourable expectations entertained of such a Union might well be disappointed.