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A Monetary Union for Europe

During its meeting in Hanover the European Council made a fresh move towards creating an Economic and Monetary Union (EMU). It commissioned a committee comprising central bank governors and other monetary experts under the chairmanship of the President of the European Commission, Jacques Delors, to study and propose concrete stages leading towards the realisation of this union. The committee's report is to be ready for the European Council's meeting in Madrid in one year's time. The European Community's heads of state and government will then study the means of bringing about this union – and probably set the process in motion.

One of the committee's first tasks will be to define what is meant by an EMU. The answer to this question will probably be more differentiated than that formulated in 1971, when the Council of Ministers made its first attempt, on the basis of the Werner Report, to outline the Community's ultimate objectives. According to the Council Resolution of 22 March 1971 the EMU was to be marked by three characteristics: a common economic area, a common monetary area, and a common economic policy. The common economic area corresponds by and large to the single internal market envisaged for 1992. Designated features of the common monetary area were the full and irreversible convertibility of currencies, the elimination of the margins of fluctuation for exchange rates, and the irrevocable fixing of parities. The introduction of a common currency was intended as the finishing touch. As for common economic policy the Community was to possess the powers and responsibility in the economic and monetary fields to enable it to ensure the management of the union. In the monetary field a common central bank system was planned, which, while remaining autonomous, would contribute towards achieving the goal of stability and growth in the Community.

Today, the ultimate economic policy and, in particular, monetary policy objectives could be similarly – though perhaps more precisely – defined. At the same time, however, it is becoming increasingly clear that, prior to the setting up of a European central bank of the Twelve and even more so prior to the setting up of a European budgetary authority of the Twelve, interim goals exist which can in themselves be economically advantageous and politically desirable. The fact that the Community's political leaders commissioned the experts to study the EMU – and not, as initially suggested by West German Foreign Minister, Hans-Dietrich Genscher, a European central bank – represents a political rejection of any “institutional leap” in the monetary field in the near future. Rather, in the eyes of the European Council “monetary union” appears to mean the creation of an improved framework for coordinated monetary and exchange rate policy activities.

Does the Community at all need a common central bank or a central bank system with a centralised decision-making authority in the near future? The interest rate, exchange rate and convertibility risks associated with the juxtaposition of national currencies in Europe

represent obstacles to the formation of a continental financial market, produce transaction and information costs resembling customs duties, and thus tend to encourage the misallocation of real and financial investments. Accordingly, the transition to a common currency could, in principle, lead to an overall saving of resources as well as to efficiency gains. Admittedly, this does not automatically mean that a European central bank and the issuing of a common currency are absolutely essential: greater economic integration, as envisaged by the goal of a single market in 1992, is possible and can be efficient even without full monetary integration.

A more significant aspect is the fact that the growing integration of commodity, services and financial markets in the Community produces a growing economic interdependence between member states. At the same time this reduces the ability of national economic authorities to autonomously counteract undesired macroeconomic developments via monetary and fiscal policy measures. The already "classic" contradiction between the goals of exchange rate stability (in the EMS), currency convertibility and economic policy autonomy is thus becoming increasingly perceptible in the Community – and will sooner or later probably become so in the Federal Republic of Germany, too, which has so far been the only EMS country able to retain a high degree of monetary policy autonomy.

Community member states can basically respond to the loss of national competence for economic policy in three ways. First, by accepting this development and following the policy of the key currency country. This option, which has been practised in the EMS – with the Deutsche Bundesbank as the key central bank – for several years, is confronted by growing opposition following the broad achievement of price stability and continuing employment problems. Regardless of the stabilisation successes it has achieved, in the long run this approach discernibly contradicts the Community's own idea of its political function. Second, by pulling out of the exchange rate system and/or reintroducing foreign exchange restrictions. With respect to the envisaged realisation of an internal market this would be counterproductive. The only remaining – third – approach, therefore, is to group national instruments at the Community level with the aim of jointly regaining lost national powers of control.

This, however, does not imply that the setting up of a European (federal) central bank or the transfer of concrete monetary policy powers to a European "Federal Open Market Committee" would already be advisable in 1992. The realisation of the internal market is a process which will by no means be completed by 31 December, 1992 (even if all the necessary legal prerequisites are achieved by that date). A great deal would suggest that the Community can carry on for some time with the current system of central rates and margins of exchange rate fluctuation in the EMS and that Britain's participation in the exchange rate and intervention mechanism of the EMS can wait until the British themselves regard their involvement as beneficial.

The committee, therefore, will have to concentrate its activities on interim steps along the path to a European monetary union. However, it can only do this meaningfully if it clearly defines the ultimate institutional objective, the status of a European central bank. In line with the nature of the Community a European central bank system is only conceivable as a decentralised and federal system. Such a system must be headed by a body with decision-making powers, which either directly determines the common policy of the national central banks or – as the central bank of all central banks – exerts an indirect influence on the monetary policy of national monetary authorities via a variation of its refinancing instruments. As successor to the anchor of stability, Bundesbank, a European monetary authority should be committed to the goal of monetary stability and be independent from political directives. An elimination of this anchor without substitution is out of the question.

Various paths towards a European central bank system have been discussed during recent weeks. Most of these proposals are based on the existing central bank structure in Europe. It will be interesting to see how the experts map out the path towards a monetary union.

Hans-Eckart Scharrer