'The European Central Bank: a precondition for monetary union' from Echos de l'Europe (January-February 1989)

Caption: Following the Hanover Summit of 27 and 28 June 1988, the Delors Committee is given the task of studying and putting forward proposals for the phases which are to lead to the creation of an economic and monetary union. The establishment of a European Central Bank proves to be an indispensable precondition for the achievement of such a union.

Source: Échos de l'Europe. Publication du Bureau de Presse et d'Information de la Commission des Communautés européennes à Luxembourg. RRéd. Chef Hoffmann, Maurice. janvier/février 1989, n° 1-2. Luxembourg: Commission des Communautés européennes. "La banque centrale européenne: un préalable à l’union monétaire", auteur:Magrini, Jean-Marc , p. 6-8.

URL:
http://www.cvce.eu/obj/the_european_central_bank_a_precondition_for_monetary_union_from_echos_de_l_europe_january_february_1989-en-16611fc8-9b78-49f2-8189-1b3d73251761.html

Last updated: 06/07/2016

European Central Bank: a precondition for monetary union

If the ECU were to become the vehicular currency for transactions between Member States, the parallel currency of national economies, and if the European Community were to have a single monetary and exchange-rate policy overseen by an autonomous central bank, only then would monetary union be a reality.

At the present time, the Commission — just like its President, Jacques Delors — is pondering a certain number of questions. Do we want a common currency? If yes, then will it be a parallel or a single currency? Who will manage this currency? A central bank? How many members, 12, 7, 6, etc., will this central bank have? What intermediary phases should there be? These questions have been partly answered by the outcome of the Hanover Summit of 27 and 28 June 1988. Indeed, the European Council reiterated that, by adopting the Single European Act, the Member States have confirmed the aim of gradually working towards economic and monetary union. To this end, they have even decided to entrust to a committee the task of studying and proposing specific phases that will bring about this union. By the time of the Madrid Summit, to be held in June 1989, the Delors Committee will, firstly, have finished its consultations, including that of the Committee for the Monetary Union of Europe, jointly chaired by Valéry Giscard d'Estaing and Helmut Schmidt, and, secondly, reached its conclusions aimed at giving new impetus to this element of the Europe of tomorrow which should allow the single market to rest on solid foundations. It is assumed that these conclusions will incorporate plans to set up a European central bank.

The ECB must consolidate the achievements of the EMS

Acceptance of the idea of a central bank has increased significantly over the last few months, and it appears increasingly to be the only body capable of truly consolidating the achievements of the EMS while remedying some of its shortcomings. The EMS, which entered into force in 1979, had three objectives. The first objective — the stability of exchange-rate relations between the European currencies — has been achieved, even if not all European currencies participate in the system in the same way: the Italian lira has broader fluctuation margins (6 % rather than 2.25 %); the pound sterling and the drachma are not in the exchange rate mechanism although they do have a role in the definition of the ECU; transitional measures remain in place for the escudo and the peseta, facilitating their adaptation to the System. Similarly, the 12 successive realignments are further evidence of the consequences of divergence in economic policy. Nevertheless, recent IMF studies have shown that the establishment of the EMS had reduced the variability of the exchange rates of the participating countries by one-third. Therefore, unlike the currencies of the OECD, amongst others, the currencies participating in the exchange rate mechanism benefit from 'a regional shock absorber', which is not insignificant at times of increased exchange-rate tension.

The second objective of the EMS — the convergence of economic and monetary policies — has been almost entirely forgotten by the Europeans. Periodic reports and recommendations by the Commission and discussions within the various Community bodies with responsibility for monetary affairs have hardly ever been followed up, even if the idea of more systematic convergence, through the joint definition of national monetary objectives, has been put forward several times by certain countries. Since the integration of monetary policies is still in its infancy, it follows that the third objective — monetary union — has never been achieved, despite the deadline of 1981 having been set at the 1978 Bremen Conference.

A brief appraisal of the EMS confirms that the creation of a European central bank is necessary. Indeed, the EMS has imposed restrictions and constraints on the management of the European economies, and the ECU has met with the support of private operators, with a rapid growth in banking transactions, financial operations and commercial invoicing. However, at the same time, certain pitfalls have come to light: negative effects of the inclusion of the pound sterling in the currency basket; destabilising effects of the movements of the dollar in the absence of a single currency to protect it; delays in exchange-rate adjustments bringing about additional constraints for countries with weak currencies.

Therefore, the current problem is not defining the objectives of the ECB but finding the political definition for this body which is set to shape the monetary Europe of tomorrow.

The ECB must be born of political will

Revised by the Single European Act, the Treaty prohibits ‘rampant’ or ‘subversive’ integration. Indeed, it provides that, ‘in so far as further development in the field of economic and monetary policy necessitates institutional changes, the provisions of Article 236 shall be applicable’, which presupposes a further revision of the Treaty. This paves the way for the changes to the Treaties which must now be made. Justification is found in the objective of creating a single market by 1992; moreover, only a ratified treaty confirming a European objective of monetary stability and establishing an explicit transfer of powers and responsibilities is fully compatible with the tasks currently conferred upon central banks by national legislation.

At the end of the process of monetary integration, the situation would be so dislocated that unanimous agreement would be essential. By 1993, if that is the date chosen at the Madrid Summit in June 1989, monetary union would comprise a single currency or several entirely substitutable currencies, a single monetary and exchange-rate policy governed by a European central bank (the actions of which would be replicated by the national central banks), common guidelines in the area of fiscal and budgetary policy, and finally, solidarity structures and transfer mechanisms.

The economic and monetary spheres are closely linked. Only by ensuring parallel progress in these two areas can tensions be eliminated. Foreign and domestic monetary policy cannot be dissociated from budgetary policy or other areas of economic policy. Currency supply and demand, particularly at central government level, must be closely coordinated. This presupposes that a consensus exists with regard to the objectives of public revenue and expenditure policy.

Numerous politicians and governors of national central banks are already looking at the issue. In general, they all agree on the same outline. Total exchange freedom and free convertibility of the currencies of the Member States both between themselves at a fixed rate and also vis-à-vis third currencies at variable rates, which implies that the European currencies would be interlinked by a parity grid that the national central banks must respect. However, the only way for the national central banks to establish such a grid would be to apply a common monetary policy which, having to ensure price and exchange-rate stability, would entail the fixing of an optimal rate of expansion for the money supply of the Member States. The role of the ECB would be to draw up and oversee the application of the common monetary policy. In particular, it would set the range for the required reserves to be deposited by commercial banks in the central banks, as well as the key interest rates for the central banks. The central banks would deposit with the ECB compulsory reserves in ECU, for which the minimum level would no longer be proportional to the exchange reserves of each central bank, but to their money supply or their monetary base. Finally, the task of issuing ECU denominated banknotes might be entrusted to the ECB. The ECU would then become both the central currency and a parallel currency.

The ECU, issued and defended by the ECB, would then cease to be a currency basket and, like the other currencies, be incorporated into the parity grid, even becoming the central currency in the grid (this is currently not the case because of the attraction force of the German mark).

At the centre of the changes to the Treaty is the creation of a European central bank with the task of ensuring monetary stability and the free convertibility of currencies. It would manage the ECU in its relations with the Community currencies and with third currencies by contributing to the development of a market of ECU-denominated financial assets, it would ensure the convergence of the national monetary policies of the Member States towards the common objective of price and exchange-rate stability. However, as a large number of experts have pointed out, the ECB will be recognised in Europe as a factor in monetary stability only if it displays the irrefutable characteristics of autonomy and independence from governments with regard to the management of monetary policy.

Given the relationship between the autonomy of the central bank and monetary stability, the ECB must be broadly autonomous with regard to national and Community political institutions, both in terms of its staff and its operation. The extent of the influence of political authorities over the appointment of governors and the implementation of the monetary and credit policy of a European central bank must be laid down in detail and strictly limited.

Financial autonomy is particularly important with regard to monetary policy: the two cycles — the creation of the currency (by the central bank) and the financing of public spending (by the Community or the governments) — must be clearly separated. A European central bank must not be required to finance Community and national budgetary deficits.

For the time being, the scene has been set: a revision of the Treaty appears to be indispensable in order to achieve monetary union. This will take time. In the interim, and to aid future development, progress must be made in terms of the existing mechanisms.

Indispensable progress with regard to the existing mechanisms

In the time which will necessarily elapse between the negotiations for and the ratification and implementation of the potential new text on the one hand, and with a view to meeting the 1992 deadline for the single market on the other, a series of measures intended to refine the existing mechanisms, prepare the ground for new mechanisms and lead to economic convergence must be taken. European Community experts must prioritise five tasks.

All the currencies of the EEC countries should, in practice, be incorporated into the EMS exchange rate system with its narrow fluctuation margins, but with accompanying measures to support the peseta and the escudo. Similarly, remaining exchange-rate controls in countries participating in the narrow band mechanism should be eliminated. The mutual possession of assets in European currencies, the coordination of interventions against the dollar on the exchange markets and an improvement in the characteristics of the ECU should be developed by a committee of the governors of the central banks. Furthermore, the credibility of the European Central Bank will be strengthened if the statutes of the national central banks all develop towards the attainment of the objective of monetary stability established by the Community. Finally, the private ECU should be fully and totally recognised as a currency.

What we obviously need, then, is a series of interdependent actions which may undoubtedly strengthen the existing system. The creation of a European monetary decision-making body requires movement on two fronts: on the one hand, political movement based on the decision to create a European central bank and, on the other hand, practical movement built on achievement, which should create an environment conducive to innovation.

On the political level, only consensus on the organisation of the economic system, on a European policy for monetary stability and on the European currency can break the deadlock with regard to a situation which, at the present time, remains unclear since national sentiments are re-emerging in the face of what is seen as an attack on an element of national sovereignty.

On a practical level, the Delors Committee should take the steps required to facilitate the next phase. Of course, there are fears, in the monetary sphere as in other areas, that a much-maligned two-speed Europe would be created. However, progress towards monetary union must not fall foul of the right of veto of one ‘backslider’ or another. Those countries which want to move forward must do so freely, while leaving the door open for the ‘slowcoaches’. Monetary Europe is a ‘grand design’ of regional cooperation which must be exploited at all costs. The Germans and the French have already begun work on it, on the basis of an Additional Protocol to the 1963 Treaty. At European level, a decisive step seems to have been taken in Hanover. The stage is set for June 1989 in Madrid.

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