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Article — Digitized Version

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Intereconomics

Suggested Citation: Scharrer, Hans-Eckart (1988) : A European central bank?, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 23, Iss. 2, pp. 53-54, <https://doi.org/10.1007/BF02927022>

This Version is available at:

<https://hdl.handle.net/10419/140116>

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A European Central Bank?

Does the European Community need a common central bank? And, if it does, what objectives and tasks should it pursue, what powers, status and organisational structure should it possess? These are questions which were taboo for many years after the failure of initial attempts to establish an economic and monetary union in the 1970s. Now they are suddenly being discussed at a political level following the initiative of Edouard Balladur, the French finance minister. Not all those engaged in these discussions, however, are talking about the same thing. The answers to the afore-mentioned questions, however, depend decisively on what is understood by a single European monetary zone and a European central bank.

The primary goal of the French finance minister, at least in the short and medium term, is to break the economic and monetary policy dominance of the Federal Republic of Germany – and especially of the Deutsche Bundesbank – in the European Monetary System (EMS) and to extend the scope for his own country's growth and employment policies. His proposals for the future institutional development of the EMS must be viewed against this background. Indeed, it would be both unrealistic and inconsistent with the Community system to expect the European Community's monetary and dollar policies to be directed in Frankfurt for an indefinite future without Germany's partner countries having a say; even the undeniable stabilisation successes of the Bundesbank cannot justify such a solution in the long run. Yet how can European monetary policy be "communitised" without at the same time depriving it of its anchor of stability – represented, since the EMS was founded, by the Bundesbank?

In the light of all historical experiences with national and international monetary systems the question of the anchor is of key importance. The most convincing solution in this respect is the setting up of a federally structured European central bank system along the lines of the American or German systems, independent of national governments and European Community organs, committed by law or statutory provisions to monetary stability, and administering a common currency for participating countries. The memorandum of the German foreign minister, Hans-Dietrich Genscher, advocating the creation of a European monetary zone and a European central bank is based on this model. Balladur and other critics of the current EMS structure, however, have not (yet) warmed to this idea. On the contrary, only recently Balladur sharply rejected the idea of central bank autonomy. The French proposals currently on the table, therefore, are also hardly conducive to the promotion of the step-by-step creation of an independent central bank system.

Balladur makes three demands. First of all, he calls for a binding coordination of the economic and monetary policies of Community member states, with symmetrical adjustment commitments by weak currency and strong currency countries. According to this proposal, no member state should be allowed to depart from objectives which have been jointly fixed via policies which are too expansive or too restrictive. At first glance this demand seems economically reasonable: the gold standard had also envisaged symmetrical economic policy adjustments. Upon closer analysis, however, the demand is only justifiable if monetary policy coordination is explicitly conditional upon the defence of monetary stability and assigned to the Committee of Governors of the Central Banks in autonomous responsibility.

The Committee could then become the germ cell of a future European Central Bank Council or Federal Open Market Committee. In a recent newspaper interview Balladur demanded "that a European institution should be given the possibility of dictating certain decisions to national central banks." However, he presumably had the Council of Ministers (ECOFIN) in mind rather than the Committee of Governors.

Secondly, Balladur calls for a diversification of the currency reserves of European Community member states, or to put it more plainly: the commitment by the strong currency countries (surplus countries), if need be, to make intramarginal interventions in favour of weak EMS currencies and to hold the amounts thus absorbed in their reserves. One immediate objection to this demand is that, as a rule, the appropriate response to pronounced differences in the development of current accounts is changes in central rates, not the defence of exchange rates against market forces. What is more, substantial intramarginal interventions by the strong currency countries could lead to a convergence of inflation rates at an average – instead of at the lowest – level. This would inevitably contradict the official EMS view of its own function as a stability zone in Europe.

Finally, Balladur would like to turn the ECU into an international reserve and intervention currency. To this end, he would like to entrust the European Monetary Cooperation Fund (EMCF), an institution under Council (ECOFIN) supervision, with the administration of the ECU and the implementation of foreign exchange market interventions vis-à-vis the dollar, and possibly within the EMS as well. Furthermore, he wishes to promote the use of the ECU as a means of payment in intra-Community trade and capital transactions, a goal he shares with the German foreign minister. Balladur's underlying intention is to curb the international role of the D-mark, and hence of the Bundesbank, in the currency triangle USA – Japan – Europe, and thus at the same time their respective roles as key currency and key central bank in the EMS. Genscher places greater emphasis on the ECU's function as a parallel currency to national currencies and thus as the preliminary stage of a future single currency in Europe.

Experience to date indicates that the ECU is unable to meet the requirements of both functions. This applies to the official ECU, for which there would appear to be virtually no need at all in the everyday monetary management of the EMS. It also applies to the private ECU, which, contrary to all the calculated optimism spread by interested parties, still ekes out a fringe existence as a national and international means of payment: The ECU non-bank deposits in banks in the European Community amount to a total of no more than 7.5 billion ECU; of this figure residents only account for 3.4 billion ECU – no more than a year ago.

The ECU also hardly stands a chance as an international reserve currency in competition with national currencies. The quality of a reserve currency results from its internal stability – the D-mark remains superior to the basket currency ECU in this respect – and from an adequate supply of both safe and liquid investment assets. If the ECU is to assume the role of an international reserve currency a broad range of government securities must be provided which can be turned into liquid funds at any time, i.e. Community member states must be prepared to incur substantial ECU debts. Finally, the idea that decisions on defending the external value of the European currencies can be viewed separately from decisions on internal monetary policy is erroneous. There can be no common dollar policy in the EMCF without a common monetary policy. To make such a demand means putting the cart before the horse.

The chances of establishing a European monetary union or at least of "dethroning" the D-mark via the ECU or the EMCF, therefore, are slim. Assuming that the realisation of an internal market calls for or necessitates parallel steps towards monetary integration there is in the long run no alternative to the setting up of an independent European central bank system. The touchstone for all future moves towards extending the EMS will be their conformity or non-conformity with this objective.

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