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## On the way to a European Monetary Union?

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# On the Way to a European Monetary Union?

**T**he Delors committee report has given a fillip to the EC discussion on the pros and cons and above all the practical shape of an economic and monetary union (EMU). In line with the doctrine prevailing since the Werner report of 1971, the group of experts advocates building up the two pillars of the EMU, a monetary and an economic union, in tandem – though not according to a set schedule.

Again in conformity with the Werner report, monetary union is defined as an area with total and irreversible convertibility of currencies, the complete liberalisation of capital movements, the elimination of margins of fluctuation and the irrevocable locking of exchange rate parities, where an independent European System of Central Banks (ESCB) decides and implements the monetary policy for the Community and manages exchange rate policy towards non-EC currencies. As a final step, a single European money would replace the national currencies.

Like the European Parliament recently, the committee has fully endorsed a federal status for the ESCB on the German model, which would mean that the ESCB council would be committed to safeguarding price level stability and be independent of instructions from national governments and Community authorities. Independence of the ESCB would also be ensured by appointing the Council members for long periods, prohibiting the granting of loans to the public sector and according it power of disposal over its own monetary instrumentarium. The ESCB would be required to support the Community's economic policy, provided however this did not clash with the aim of maintaining monetary stability.

It would be wrong to see in this proposal of the committee to the European Council – and it is no more than a proposal – a “victory” for Germany. If at all, the victor is economic common sense. Over the last two decades, since the switch to floating exchange rates, the German version of the separation of powers in economic policy between government and central bank has proved its superiority to other models. Though certainly not infallible, the policy of the Bundesbank has not been subject to systematic errors, as tends to be the case for economic policies geared to winning votes. As far as maintaining price level stability is concerned its course has always been credible. In setting clear parameters to the budgetary policy of the government and the incomes policy of management and labour, it has helped sustain stable economic growth – where these parameters have been observed at least. As the Delors committee explicitly stresses, the European Monetary System has benefited from the D-Mark's and the Bundesbank's role as anchor. Dispensing with this anchor for reasons of “pure” democracy, therefore, is not up for debate.

All this is addressed to those who do not (yet) favour the Delors model. The French economics minister, Bérégovoy's declaration in a newspaper interview that he would prefer an “autonomous” European central bank to an “independent” institute, while claiming such “genuine” autonomy for no less than the Banque de France is enough to raise doubts in the Federal Republic of Germany and elsewhere as to the benefits of an EMU. These misgivings

deepen when he argues for embedding the monetary policy of the ESCB in overall economic planning as defined by national governments – with no concession to stability considerations whatsoever – at the same time calling for greater powers for the economics and finance ministers of the member states.

The critics of a European monetary structure on a German model should know that even this arrangement is by no means a safe bet from the German standpoint. There would in fact be no guarantee at all that the ESCB would pursue a monetary policy along the same lines as the Bundesbank has done. Rather, the socio-economic traditions of some countries likely to affect the attitudes and decision-making of the members of the ESCB council give rise to doubts concerning the importance members will attach to stability. The initial phase in which monetary stabilization needs further to be practised is thus just as essential as the possibility of establishing an EMU with a “variable geometry” starting with the participation of only a few member states. It would be a mistake to establish a European reserve fund as this would be to misplace the emphasis on exchange rate policy.

The Delors report's proposal that the monetary union be established by progressively constricting the margins of currency fluctuations is unrealistic. Any narrowing of the bands for bilateral exchange rates augments the need for intervention, irrespective of economic convergence measured according to statistical indicators. “Irreversibly” pegged exchange rates between national currencies would also keep testing the market, possibly to destruction. So, the avenue proposed by the group of experts would seem as impracticable as the backdoor route of a parallel currency, which has been justifiably rejected. If we want a monetary union, we shall have to make a qualitative leap from the EMS system of bands to a standard currency.

According to the Delors report, the basic preconditions for an economic union to be set up in tandem with the monetary union are the completion of the European single market, an effective competition policy, common policies on structural adjustment and regional development, and the coordination of macroeconomic policy. The first two are unlikely to be much in dispute. Positing the harmonization and integration of monetary policy as a rationale for enlarging funds for regional assistance or for a sectoral policy of structural adjustment on Community scale, however, is untenable. With appropriate national economic policies (including wages and salaries), a high level of monetary stability will not entail inroads into employment or growth and the Community should not fund non-economic policies. Correctly, the Delors report warns against subsidizing incomes and it underlines the role of wage flexibility and mobility of labour for regional development.

Finally, the committee calls for binding rules and procedures to curb national budget deficits and for setting the overall course of economic policy in the mid-term. It is difficult to imagine how this could be practically implemented; in the final analysis, it would involve depriving national parliaments and governments of their sovereignty. Indeed, conferring effective powers in economic and budgetary policy onto the Community is beset with far greater technical obstacles than the creation of a monetary union, but then, it would not seem to be imperative. Many coordination functions can be entrusted to the market. How much of a genuine need there is to give the Community greater powers in economic policy can be carefully tested in the first phase of the EMU.

The question of whether the European Council in Madrid will convene an intergovernmental conference to amend the EEC Treaty is premature. There is no need to alter the Treaty in order to embark on the first phase of the EMU, although the Committee of Governors of Central Banks, the institutional forerunner of a future ESCB council, will have to receive an explicit mandate to conduct its managerial task. This mandate should include a commitment to the objective of price stability. Stabilization policy in the EMS, which has managed to largely equalize inflation rates at a low level and hence ensure a high level of exchange rate stability in the last two years only, will have to withstand new external and internal shocks. Cooperation in the Committee of Governors of Central Banks and in the ECOFIN Council will be the litmus test of the member states' resolve to bring about a European economic and monetary union.

*Hans-Eckart Scharrer*