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European Monetary Union – Why, When and How?

The first phase on the path towards European economic and monetary union began parallel to the establishment of German monetary union on 1st July 1990. The most important specific characteristic of this phase is the fact that there are – with a few exceptions – no longer any restrictions on capital transactions within the EC. One political objective of this phase is, via the strengthening of monetary policy coordination between the central banks of the EC member states, to contribute towards the greater convergence of economic development in the individual countries, which in some cases still varies quite considerably.

Increased convergence is intended to make possible the transition to a second phase, which the EC Commission would like to see beginning parallel to the completion of the Single Market on 1st January 1993. This second phase is to be dedicated largely to the establishment of the new central bank system and is intended to be brief, so that the final stage – the creation of a single currency and a common monetary policy – can rapidly be achieved. The conditions necessary for the second stage are to be created in the intergovernmental negotiations beginning in Rome on 13th December 1990.

The meeting of EC Ministers of Finance in Rome on 7th September was also part of the preparations for these negotiations. The EC Commission's timetable outlined above appears to have come unstuck there, however. The sceptical attitude of the British towards the idea of surrendering their monetary sovereignty to a European central bank was already public knowledge prior to the meeting. It was also known that the Germans and Dutch feared that the planned institutional regulations would not be able to commit the new "Eurofed" to the goal of monetary stability to an adequate degree.

Other countries, or at least their Ministers of Finance, have now joined the ranks of these "doubters". Greece, Ireland and Portugal, for example, are now pleading for a slower treading of the path towards fixed exchange rates and a common monetary policy, since they – due to the costs of German unification not only for West Germany but also for the EC as a whole, due to the aid to the Eastern European countries and perhaps also because of the uncertainties arising in connection with the Gulf crisis – suspect, not unjustifiably, that the funds will not be made available to them which would enable them to achieve a relatively "friction-free adjustment" to conditions under an anti-inflationary policy with fixed exchange rates. Spain's adjustment problems following its accession to the European Monetary System (EMS) probably played a role in the fact that the Spanish Minister of Finance also pleaded for the postponement of the introduction of a single currency until the end of the century. The remaining countries, particularly France, Italy, Belgium and Denmark, but also the West German Foreign Minister, are in favour of sticking to the EC Commission's original timetable.

In view of this medley of opinions it would seem not inappropriate to reflect anew on some of the "basics", in order to be able to judge the individual arguments better. An "EC monetary union no matter the cost" – as one German daily newspaper called it – can certainly not be an aim in itself, particularly as it is possible to be of differing opinion as to the absolute necessity of a single currency or of fixed exchange rates even in a European political union. In the final analysis, the weight of the various arguments depends heavily on the opinion one has as to the concrete form a political union should take. One can come to quite differing results depending on whether one favours a more unitarian form or a strongly federalistic one. Vice versa, the plea for a common currency also implies certain conceptions and consequences for the type of shape a political union should take. And this of course is precisely where the doubts of the British in particular arise.

In principle, there are two arguments in favour of a single currency: a political one and an economic one. Politically, a single currency is a visible symbol of a single Europe – a common

tie which can be felt by everyone in their day-to-day lives. Economically, a single currency reduces the microeconomic costs of "transborder" transactions, whether of labour, capital, goods or services. However, if the political tie is not to become a burden and if the danger is to be avoided that the microeconomic savings on transaction costs are more than compensated for by macroeconomic disadvantages (costs), then certain conditions must be fulfilled. These include an anti-inflationary monetary and fiscal policy as well as institutional provisions to guarantee this. The crux of the matter is to be found in the answers to two questions: Does the transition to another system guarantee that stabilization policy will be better, or at least will in no country be worse, than previously? Is this also guaranteed for the transition period? Only if these questions can be answered in the affirmative is the system transition politically and economically advantageous. If not, the political binding function would have to be considered to be of higher value than the possibly ensuing macroeconomic costs and the political damage which could in turn arise from them.

If it is decided that a single currency is to be introduced, the question arises as to the best way to go about this. In order to achieve a single currency it is theoretically not necessary to create a new one. To quote Milton Friedman, "... to achieve it requires eliminating all central banks in Europe ... except one..." Under present conditions this would mean officially according the Bundesbank and the D-Mark the functions which they already in fact fulfil within the European Monetary System, namely those of an independent, stability-oriented institution and anchor currency, which – at least until now – have exerted anti-inflationary pressures on the other EC members participating in the exchange-rate mechanism.

Three theoretically possible arguments speak against this construction: firstly, national or emotional resistance to "subjugation" to the monetary policy of the central bank of a single EC country; this argument would lead to the demand for the creation of equal or even better institutional provisions for a successful anti-inflationary policy at the European level, i.e. the institutional framework for a monetary policy such as that laid down in the Bundesbank Law would constitute the minimum standard.

Secondly, it is considered desirable that monetary policy pursue further economic policy goals, i.e. a strict poling towards the goal of stabilization of the overall price level alone should be avoided. It is well known that not every country desires this. The fears of these countries in this connection could be eliminated by a corresponding organisation of the European Central Bank System, by the delegation of competences and appropriate regulations pertaining to the terms of office and composition of the board or council. The discussion on these questions to date gives no clear picture, however, as to the degree of preparedness to do this.

Thirdly, in favour of a rapid transition to European institutions and at the same time retaining the national currencies is the consideration that it would then more easily be possible for the individual central banks to support an anti-inflationary policy in their own country in the transitional period by referring to European necessities, without having to abandon the instrument of exchange-rate corrections once and for all. Of course, this argument presumes that an anti-inflationary economic policy is aimed for at the European level, which in turn requires that the necessary institutional provisions are made.

The will to apply such a policy could be documented at the present time by all of the member countries declaring themselves prepared to subject themselves to EMS regulations and – where necessary – to plan appropriate adjustment programmes. Those countries with considerable adjustment problems should in that case be offered the necessary assistance in advance to finance the transition. On the basis of the convergence which could thus be achieved, the exchange rates would become more stable and the qualitative jump to a single monetary policy and a single currency would be easier. On the other hand, the concepts which consider the possibility of varying speeds for the various country groups within Europe on the road towards monetary union reduce the weight of both the argument of the common tie and the microeconomic argument for a single currency, without answering the fundamental question as to the preconditions for a clearly anti-inflationary monetary policy on a supranational basis.

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