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Lessons from the Currency Storms

The positive outcome of the French referendum just managed to save the Maastricht Treaty from final oblivion, but the extremely close result – after all, about half the electorate, as in Denmark, rejected the Treaty – the severe turbulence on the currency markets and some shrill political dissonance in the run-up to the referendum have made it quite impossible to simply get back to “business as usual” in Europe.

The high percentage of negative votes attests to the disquiet felt by many – and by no means only those who voiced their disaffection in an audible “no” to Maastricht – at a Europe run by technocrats and drifting ever further away from the ordinary citizen. There is a lot of nostalgia underlying this: the desire to preserve tried and tested – or just familiar – national regulations and standards, to shelter from the challenges of international and European structural adjustment and competition. It also, though, reflects a healthy distrust on the part of Europe's citizenry towards a Euro-bureaucracy which, with scant democratic approval, is striving under the auspices of an allegedly necessary harmonization and legal alignment to maximize its regulative powers at the expense of the member states and their parliaments. The legal provisions in the Maastricht Treaty on the role of the European Parliament and the principle of subsidiarity are hardly likely to dispel these fears.

With the turbulence on the currency markets, the forced devaluation of the peseta and the temporary withdrawal of the lira and the pound sterling from the exchange rate mechanism of the EMS, one of the bases for the progressing of the Twelve towards a monetary union is no longer applicable. The initiative for a common European currency was based on the – explicit or implicit – premise that economic convergence amongst the member states of the EC was already so far advanced that adjustments of central rates would in future – as had been the case over the last five and a half years – be ruled out and that almost all countries (with the possible exception of Greece) would be economically ready for monetary union by 1 January 1999 at the latest. In the intergovernmental conference, the notion of a “Europe of different speeds” was dismissed as discriminating, in particular by the “southern states” – flying in the face of all economic reason – and the countries belonging to the stable core were reluctant to pursue this idea for reasons of foreign policy considerations. The conditions for taking part in monetary union (convergence criteria) were accordingly defined in soft terms, according to the motto, “knock and ye shall enter”.

Now the markets have jolted the advocates of an early monetary union with maximum participation out of their political daydream and into hard reality: a good number of countries are not yet economically ready for a monetary union the aim of which is monetary stability and it is unlikely that they will be in the remaining four to six years left to achieve it. Many political decision-makers do not wish to hear this truth and therefore denounce the processes on the markets: as the work of speculators, who can best be thwarted by moving faster along the road to monetary union, as the result of a ruthless high-interest policy by the Bundesbank and its representatives' (deliberate or at least irresponsible) talking down of exchange rates, as the consequence of Germany's loading the costs of unification onto the partner countries.

In truth, the “speculators” have performed the service of tearing down the political veil covering the EMS since the Conference on Economic and Monetary Union and revealed the pent up, fundamental imbalances between the centre and the periphery. At the southern periphery of the EC and in Great Britain prices and unit labour costs have been rising for many years much faster than in the central countries without being matched by product adjustments towards higher quality goods. A number of other adverse economic developments have also accumulated. It is these real economic disparities that have ultimately forced the devaluations, disparities that would not have engendered monetary crises if we had had a common currency, but would probably have caused growing regional production and employment distortions in Europe – and these would have been more difficult to remedy.

There was therefore no need for an alleged “talking down” of the pound by the Bundesbank: the markets had already drawn their own conclusions that sterling was overvalued. Nor can Germany’s interest rate policy be blamed for the pound’s and the lira’s problems: notwithstanding the restrictive monetary policy in Germany and the burden of financing German unity, the short-term and long-term interest rates were always lower than in any other country in the Community. In fact, it was only by joining the EMS and through the related confidence bonus it afforded that Great Britain gained the necessary leeway to lower interest rates at all in the past two years, a leeway which it now felt to be too narrow. Did the British Government seriously think that a bigger cut in German interest rates would have solved Britain’s foreign exchange problems although raising its own central bank discount rate by five per cent failed to save the pound?

Even if we rate the contribution of high German interest rates to the disruptions on the foreign exchange markets as low, however, there is still the question of whether the Bundesbank should not in its capacity as the leading central bank of the EMS be generally more closely geared to “European” rather than German indicators. Apart from the legal difficulties this would involve – as Germany’s central bank, the Bundesbank in the first and second stages of economic and monetary union is still subject to the provisions of the Bundesbank Act – it is by no means clear whether such a mandate would have entailed or would entail pursuing a substantially different policy: prices in various European countries (including in particular Britain and Italy) are still rising faster than in Germany. A more expansionary policy would only seem appropriate if monetary policy were accorded a different role in economic policy planning to that which it has long played in Germany and is also intended to play in future in Europe, according to the wording of the Maastricht Treaty. The proponents of a less restrictive policy actually see the role of the central bank as being less in securing the value of money and more in stabilizing employment, a job better to be performed by wages policy and fiscal policy.

The fact is that the Bundesbank could relax its tight monetary policy if it were given more support from the trade unions and management on the wage and price front as well as from budget policy. Social interest groups and the Federal Government tend to rely all too easily on the Bundesbank, the “guardian of virtue”, leading – and if necessary coercing – them back to the path of stability. If they were to voluntarily conduct their affairs with more of an eye to stability, the Bundesbank could take greater account of monetary trends in the partner countries in its policymaking. It must, of course, also be stressed that the key central bank in the system is obliged to maintain credibility where price level stability is concerned: one of the reasons the Bretton Woods system collapsed was that the internal value of the dollar, the anchor of the system, had been eroded.

The lesson to be learnt from the latest events, then, cannot be to soften the D-mark, the EMS or the stability standards of Maastricht. If monetary union is to have any chance at all, it must be in the circle of countries that prevailed as a union of stability in the September storms.

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