Conference notes from the Cicero Seminar key issues in preparing for Economic and Monetary Union Paris, 9 & 10 October 1997

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Tweedledum and Tweedledee

Um and Ee

Is that right? Oh I see.

They've got it backwards, Ee and Mu

A Single Currency

But here's the rub

Now we see it, now we don't.

Or do we?

Probably many people like me had similar ruminations about Economic and Monetary Union in a Europe of the 10, 12, 15 or perhaps 20 nations who may eventually be included at Stage 1, 2, 3 and 4, if and when any of these happen. But, for me at any rate, a happy set of circumstances, possibly triggered by my writing a letter to the editor of the *Financial Times*, led me to be invited to take part in one of the Cicero Foundation's Great Debate Seminars. Joining me were fifteen participants from Russia, Latvia, Poland, Turkey, Romania, the Czech Republic, Austria, Sweden, the Netherlands, the UK, France, Portugal and the U.S.A., with speakers coming from the E.M.I., the European Commission, the

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OECD, the European Parliament, the Russian Academy of Sciences, the Sorbonne, the Manchester Metropolitan University and the Economist.

The idea was that we should discuss several of the many questions which still have to be resolved before the euro is launched, including: 1) What are the prospects that it will be launched on time on January 1, 1999? 2) What will be its impact on European trade and industry? 3) Will the euro replace the dollar as a reserve currency? 4) Will this and the thereby implied strength of the euro depend on how much political influence can be exerted on the European Central Bank? 5) Will it be a straitjacket for the member states or an incentive for good economic management? 6) How will it affect a) non-participating EU member states and b) candidate member states from Central and Eastern Europe?

The conference was opened by the Cicero Foundation's Director, Marcel van Herpen, who was greatly instrumental in founding this Dutch non-profit organisation in Maastricht in 1992, its aim being to provide a broad, global forum to discuss issues that are of central importance to European integration. His approach was straightforward. The aim was to stimulate discussion of the issues with the speakers who had been invited to air the principal problems facing the European Community in the roll-up to the start of the Single Currency. At the same time, he hoped that the two (alternate) workshop sessions included in the programme would give those interested a full opportunity to exchange ideas with one another.

The speaker for the first session, Mr. Francesco Mazzaferro, from the Monetary, Economic and Statistic Department of the European Monetary Institute, gave a broad review of the political, economic and financial dilemmas that the EMI has to resolve, as it prepares the ground for the European Central Bank in particular, and for Economic and Monetary Union in general. His brief was that the chief difficulty lay with resolving the differences between the German and French governments as to whether economic considerations should play a part in the decisions to be taken by an independent central bank. The Germans wanted no part in an E.C.B. that would be required to finance economically irresponsible governments, whereas the French wished the Bank to be responsible to some kind of politically representative body.

After the morning break for coffee, Mr. Peter Bekx, the Head of International Aspects of Monetary Union for the European Commission's Directorate D, Directorate General II, spoke about EMU's implications for candidate member states from Central and Eastern Europe. His brief was that EMU could well stimulate these countries to adopt sounder monetary and budgetary policies, if only because one of the prime criteria for inclusion in the EMU was that a country had to have a developed free-market economy, as well as a satisfactory fiscal approach to financing its particular social requirements. When pressed as to whether convergence criteria would not be too limiting for countries emerging from centrally controlled economies, he expressed the view that special considerations might have to be given but that, at the same time, the existing member states would have to be ensured that their own economies would not be prejudiced by having to support weaker economies seeking inclusion.

This view was supported by the first afternoon speaker, Mr. Mike Kennedy, Head of the Money and Finance Department of the OECD in Paris, who pointed out that one of the OECD' s recent reports contended that, even in the case of the existing members of the European Union, there are good economic as well as political arguments in favor of a flexible interpretation of some of the convergence criteria.

In response to questioning, both Mr. Kennedy and, before him, Mr. Bekx stressed the point that the main consideration for the European Central Bank would be that of maintaining the credibility of the Single Currency. Thus, the economies of new entrants to the club of those included would have to be sufficiently strong for their inclusion not to pose any threat to the euro' s stability.

After the afternoon break, came the hour for the two alternative workshops, the choice being that of attending the one on the political aspects of EMU or that on its economic aspects, which dealt principally with the impact the Single

Currency might have on European Trade and Industry. Most of the participants chose the latter, only three, including myself, chose the former, my reason being that it treated with the question of how much political influence should be exerted on the European Central Bank, once it came into being.

To assist us in our deliberations at this Political Aspects workshop, we had been provided with a seven-page paper entitled Central Bank Independence and Monetary Stability in the EU, written by Joerg M. Winterberg, head of the Economics and Development Department at the Research Institute of the Konrad Adenauer Foundation, in Sankt Augustin, near Bonn. The initial abstract stated: «The European Union (EU) is engaged in a new discussion on the independence of the future European Central Bank (ECB). The German Finance minister heated it up through the proposal to revalue the gold reserves of the Bundesbank to prevent a further increase in Germany's new borrow(ing)s and thus to ensure compliance with the qualifying criteria for the agreed European Monetary Union (EMU). Frank objection by the Bundesbank has refocused attention on the cardinal question of the decision-making process in the event of a dispute between (the) government and the central bank. Prior to this proposal, comments by the French sociologist Pierre Bourdieu to the effect that the adoption of the 'Tietmayer model' (named after the president of the Bundesbank, who favours strict monetary stability) represented a risk for the EU had already triggered a Franco-German dialogue on the status of the ECB. What differences of opinion exist between Germany and France? How autonomous can the ECB be, and what effects will the conflicts to be expected both within its controlling body, as well as between this body and the national governments and the EU Commission, have on the monetary stability of the common European currency?»

The points within this paper which I found of chief significance were, firstly, that «in France there is a growing body of opinion that points out that an important goal envisaged by the EMU was being neglected: to break the dominance of the Bundesbank (...)» Secondly, «French monetary policy has traditionally tended to orient itself to the external rather than the internal value of the franc, i.e. to the exchange rate, not the inflation rate (...). The country tended to be more interested in a soft franc to improve its export conditions and to ensure full employment conditions, rather than in monetary stability. Optimists point in this context to the French successes in the fight against inflation over the past ten years and to OECD forecasts, which also predict an inflation rate for 1997 and 1998 which is lower than Germany's. (...) However (...) the steady lowering of the inflation rate (...) in France since the eighties has been paid for with serious disadvantages — higher interest rates, lower growth, and a loss of jobs.»

Thirdly, the Maastricht Treaty stresses that the central banks' efforts towards ensuring price stability must not be characterised by goal conflicts and, if the functional independence of the ECB is guaranteed, under Article 2 of the Protocol, it is solely committed to the objective of monetary stability and is only allowed to support general economic policies in the EU, «if this is without prejudice to the objective of price stability».

Our workshop itself had the advantage of using a small and comfortable lounge with easy chairs that contributed to a pleasant informality to our proceedings. The participants were Mag. Dr. Barbara Eggl, of the Central Bank of Austria; Ing Karel Zeman, of the Czechoslovak Obchodní Bank in Prague, and myself. Our exchange of ideas started off in a conversational manner, with my asking what the others thought about Joerg Winterberg's article.

Dr. Eggl summed up her reaction with the short conclusion that she thought there was little doubt that the German approach would prevail. Ing. Zeman concurred, adding that he felt that it was essential for the E.C.B. to be completely independent of political control. Otherwise, he said, the euro would end up being an undesirably weak currency. His concern was that the Bank might tend to take inflationary stances.

Taking very much the position of 'devil's advocate', I agreed that the E.C.B. should maintain its independence, despite the fact that it might mirror the

Bundesbank too much and maintain high interest rates to the unnecessary detriment of some of the Union's economies, as had been the case when they triggered the departure of Britain and Italy from the Exchange Rate Mechanism. My fear lay not that they would take too inflationary stances, but that they would tend to be deflationary too often, by provoking economic recessions with higher interest rates whenever the EU started to show growth, in the manner currently prevailing in the U.S.A. This provoked the beginning of what turned about to be a friendly discussion of the pros and cons of the almost inevitable German modeled E.C.B., and, particularly the need to have it independent from any political influences that might require it to finance wastrel government spending in one or more of the, say, eighteen EU countries. Also, after a similarly friendly but lively exchange, we agreed on how necessary it is for the ECB to have to account for its actions to and take into consideration the views expressed by bodies sensitive to and representative of the peoples affected by its decisions.

The workshop was followed by the first day's final speaker, the Rt. Hon Fernand Herman, MEP and formerly a Minister of Finance for Belgium. His address reassured many of us of how accountable the ECB will be obliged to be under the terms of the Mâastricht Treaty. For, not only does it have to publish its reasons each time it makes a decision, it has to produce full business reports twice a year and is accountable both to the European Parliament and ECOFIN (the European Council of Finance Ministers).

When asked whether there was any chance of Article 2 of the Protocol being amended so as to have the ECB give equal weight to considerations of monetary stability and the support of general economic policies throughout the EU, he relied that there was none. It would take forever to achieve any amendment to the Protocol. But, he opined that, although Article 105 of the Treaty set the main, governing, term of reference for the ECB, they were, when it seemed necessary, very likely to take account of the provisions of Article 102, which did require the ECB to consider how their decisions were likely to affect the various economies involved. Nonetheless, like the earlier speakers, Mr. Herman was at pains to stress that, in his view, it was necessary for the Euro to be and remain strong and that it could only do so if the ECB's stance and monetary policies were seen to be consistent and, above all, credible.

For the sake of brevity, I shall select from the second day's proceedings what were, for me, the three more relevant addresses.

The first of these was a refreshing departure from the main topics. Dr. Olga Butorina, Head of Sector of Economic Integration at the Russian Academy of Sciences, filled in for a missing speaker from the Deutsche Bank, by giving a talk of her own regarding the problems the use of the euro might pose for what she called Third European countries. She mentioned the legal issues that could arise, particularly since EU rules and contract law could not be extraterritorial. And she wondered about the acceptability of the euro for settlements to Russia, if the German mark were to be converted to the euro. For the present and the foreseeable future, for the CIS. countries, the US dollar had the status of an 'esteemed' currency and acceptance of the euro would depend on its strength and credibility in the medium and long term. Their concern was whether settlement in dollars could continue.

Raising the point that settlement in U.S. dollars was bound to continue in very many situations, because, apart from all else, the joint reserves of the EU's central banks at present total some 400 billion dollars, I submitted that it is unthinkable that, even if the euro starts to function as a reserve currency, it would be policy to have it do so at more than a very slow rate, if only, because of the chaos within the world's overall monetary systems, were European banks to start to wind down even as little as 20% of their seemingly redundant reserves of dollars. Added to which, the C.I.S. could surely also look to making international settlements via the B.I.S. (Bank for International Settlements) in Basel.

The question I then put, in response to her suggestion that consideration should be given to some kind of associate membership for Russia, was that of how soon she could see her country fulfilling the criterion of having a free-market economy. I confessed to not understanding what was going on in Russia, since it is confusing for us in the West to see the hassles between the Duma and President Yeltsin over each and every one of his attempts to move forward with reform. Her fascinating reply was that there was a Russian poet who provided the answer that nobody could understand what was going on in Russia. You just had to believe it.

At this, Dr. Leszek Jasinski, of the Office of the Warsaw Committee for European Integration and an Advisor to the Minister, showed that, amidst all our earnest economic discussion, he had his civilized priorities right. He asked who this poet was. And I think, though I only half caught the answer, that Dr. Butorina replied 'Pushkin'. She then followed up with an intriguing challenge to our way of seeing things in the West, pointing out that over the past decade enormous changes had occurred in Russia, whereas her people were astonished, when they came to the West, by how little we had changed in our approaches.

Her address was then followed by a distinctly British critique of the assumptions that all would be well within the EU. Given by Dr. Frank McDonald, Head of the International Business Unit at Manchester Metropolitan University' s Faculty of Management and Business, it was an excellent summation of the effects of economic policy changes on the real economy and the inherent problems and c osts of adjustment that would face countries joining the Single Currency.

The third address was given by Professor Christian de Boisseau, from the Sorbonne. His theme was whether there was a chance for the success of one of the main political objectives behind the EMU project, that of making Europe less dependent on the dollar.

The problem posed to me by this objective, as a result of his talk, remains the one of how strong the euro might be. Because, if the EU's G.D.P in 1999 is to be a little over U.S.$9 billion, thereby exceeding the U.S.A's G.D.P. by some 14%, as well as being around half as big again as the G.D.P. of Japan, the euro would very quickly become the world's principal trading currency. Then, and here would come the dilemma, because what presently constitutes «foreign» trade with other European countries would turn into «domestic» European Union trade, the EU would be running a joint current account surplus of over U.S.$100 billion.

The European central banks would be in a position to reduce their joint dollar reserves by, depending on the number of countries which join in the euro at its outset, between 20% and 50% of the present total of U.S.$400 billion. But, if they did, what would happen to the U.S. dollar? Not only would it plummet, leaving the U.S.A. unable to finance its current account deficits (forecast by the I.M.F. to be U.S.$205 billion in 1998). The potential time-bomb could wreck the world's monetary system beyond repair. Surely, therefore, we are left with the conclusion that concentration on making the euro a principal reserve currency, and the consequent currency competition that may ensue, should be replaced by a concentration on developing a system of cooperation between, say, three or four reserve currencies?