Jürgen Stark: The ECB and other European institutions and the future of the euro

Address by Dr Jürgen Stark, Deputy Governor of the Deutsche Bundesbank, at the 3rd Euro Capital Markets Forum in Amsterdam on 2 April 2001.

*   *   *

Introduction

In my statement I intend, in particular, to address the following two questions:

1. Almost three years after the establishment of the ECB, how is that institution to be rated in terms of its strategy and policies?
2. What are relations like between the ECB and other EU institutions or fora, especially the European Parliament, the ECOFIN Council and the Eurogroup?

I do not propose to address the future of the euro in the way you are probably expecting. Instead, I shall go briefly into the question of how to ensure the lasting success of Economic and Monetary Union (EMU).

My overall verdict on the first question will not come as a surprise: right from the start, the ECB has done good work. EMU is functioning. Yet the challenges remain great, and the ECB still has to pass the real acid test.

At a certain distance in time from the launch of the ECB and from the transition to Stage Three of EMU in Europe, the sheer dimensions of the project must be called to mind once again.

First of all, the **political** dimension of EMU:

The highest degree of monetary integration was reached in the shape of monetary union. The member states of the euro area have agreed to share a common fate. There is no way back. In other words, EMU is "doomed to success". Moreover, the residents of the euro area still have to be won over to the euro.

The new political "regime" is not simple: a single monetary policy is being accompanied by largely decentralised economic and fiscal policies. But this regime is necessary, and it works, even if it is often difficult to make clear to non-European observers. Close coordination of economic and fiscal policies is essential, but not necessarily a Europeanisation of those policies. Potential problems posed by national and regional disequilibria within the euro area will have to be solved by greater flexibility at the national level.

By contrast, any Europeanisation of economic and fiscal policies would call for Community instruments – especially the instrument of financial transfers – and an efficient supranational institution. Neither is provided for – quite deliberately – in the EC Treaty. Consequently, there is no "representative vis-à-vis the outside world" of the non-existent single economic and fiscal policy of the euro area. I shall revert to this point.

Besides the political dimension, there is also a **technical** dimension:

The internal preparations for Stage Three of EMU at the national central banks entail immense efforts. The numerous technical problems had to be resolved by means of close cooperation between the national central banks. Only those with insight into those preparations can judge the true dimensions of that task. In EMU, different "cultures" collided. For instance, close coordination was needed between different modes of procedure in market operations, in payments, in settlement systems and of course in exchanges of views on the different transmission mechanisms. Given the potential technical risks associated with the launch of EMU, this has all worked unexpectedly well.

Despite these observations, the ECB and the Eurosystem have been exposed to significant criticism in various respects in the past few years, particularly from academic economists and Anglo-American commentators. That criticism covered:

- firstly, the monetary policy strategy of the Eurosystem,
- secondly, the transparency of the ECB Governing Council's decisions, and, in that connection,
- thirdly, the relationship of the ECB with the European Parliament, in particular.

1. The monetary policy strategy

The monetary policy strategy of the Eurosystem is tailored to the specific situation of the euro area. The transition to the euro signifies a radical regime shift for monetary policy. Hence the monetary policy strategy had and has to take due account of uncertainties relating to potential changes in the transmission mechanism. These factors must be borne in mind in any assessment of the Eurosystem's monetary policy strategy.

Under the terms of the EC Treaty, the monetary policy strategy of the Eurosystem is serving an unambiguous objective: price stability. That strategy is based on two pillars: the growth of the money stock M3, which plays a prominent role, and a broadly-based assessment of the outlook for future price movements.

Some critics consider this to be confusing, and call for a clear orientation towards the money stock, whereas others demand an orientation towards an inflation target. It must, however, be made clear that the two-pillar strategy is an autonomous European approach. The money stock plays a prominent role within the Eurosystem. It is, however, only fitting that, in view of the possibility of changes in money-holding patterns owing to the introduction of the euro, consideration of the money stock should be supplemented by an assessment of inflation prospects based on a broad range of indicators.

It is only the combination of the strict orientation of monetary policy towards an unambiguous objective – price stability – and a pre-announced strategy – the two-pillar strategy of monetary growth and inflation prospects – that guarantees the transparency of the monetary policy decisions taken by the Eurosystem, and their public control. In addition, the Eurosystem informs the public regularly about its assessment of risks to stability (through press releases, press conferences, etc.), thereby contributing further to the transparency of its monetary policy decisions.

The policies of the Eurosystem are often compared to those of other systems. But the Eurosystem need not shrink from comparison with other monetary policy strategies. Incidentally, in this connection the question has already been raised as to which monetary policy strategy other Central Banks pursue, if not "looking at everything".

2. The transparency of the ECB Governing Council's decisions

Transparency is an ambivalent concept. An "excess" of information may also result in less transparency of monetary policy decisions. In the debate on the transparency of monetary policy, quantity and quality are often confused. More information does not automatically imply more transparency. On the contrary: more information may easily give rise to confusion, and thus to less transparency. Hence "natural limits to transparency" exist: perfect transparency would imply that the central bank must make available all the information which contributed to its decisions. For purely practical reasons, this is impossible. In practice, therefore, transparency is invariably partial, and can never be complete and perfect in the sense of the theoretical models.

Criticism of the alleged non-transparency of the Eurosystem's monetary policy, and calls for the publication of minutes, are heard particularly often from the Anglo-American press and academia. Remarkably, the disagreements about assessing inflation forecasts between the members of the decision-making bodies of those Central Banks that publish their minutes have engendered confusion precisely among those commentators who insist on the publication of the minutes of the ECB Governing Council.

In the specific situation of the Eurosystem, the publication of minutes would pose particular risks. Whereas the entire euro area is considered in the ECB Governing Council, national viewpoints are the rule among the general public, and also among policy-makers and the parties to pay settlements. That is illustrated by the frequently-asked question "is a change in interest rates good for our country?" Hence the publication of minutes involves the risk of political or public pressure on national central bank governors (on the mistaken assumption that they should represent the interests of their own country), and thus of a “re-nationalisation” of monetary policy in Europe.

Besides, it must be said that the informative value of the minutes of individual central banks, as published hitherto, cannot be compared to that of the “introductory remarks” of the President of the ECB at the ECB press conferences following meetings of the Governing Council, in which the arguments put forward during the discussions in the ECB Council are summarised. Moreover, these summaries are published directly after a meeting of the Council – i.e. virtually “in real time”.

Excessive transparency can make the central bank a “hostage” to market sentiment. In monetary policy, therefore, transparency is not synonymous with short-run predictability. Central banks would then be constrained to react solely in order to meet short-term expectations. Hence there are limits to central bank predictability, as monetary policy makers must have the option of taking the financial markets by surprise in the short run, to ensure that the central bank can counteract undesirable developments. In the long run, however, monetary policy must be predictable.

Predictability does not result in greater credibility. Credibility arises in a process whereby monetary policy has to prove that it can achieve its objective of preserving price stability in a complex economic environment fraught with uncertainties. Monetary policy must, therefore, work on its credibility by consistently accomplishing its stabilisation task.

3. Relations of the ECB with other European institutions and fora

A new supranational institution in Europe also has to be assessed in terms of its relations with other institutions. Particularly with the European Parliament, the ECOFIN Council and the Eurogroup.

Relations with the European Parliament and the ECOFIN Council are governed by the EC Treaty. The crucial principle is that the independence of the ECB must not be called in question. The consequence of that high degree of independence is that only the principle of ex post reporting is enshrined in the EC Treaty, but not that of accountability.

Because the ECB has a mandate, and is independent in order to fulfil it, it has to be held accountable, and is obliged to explain and justify its decisions ex post. Hence any idea of putting the “monetary dialogue” between the European Parliament and the ECB or between the Eurogroup and the ECB in the service of the ex ante coordination of a specific policy mix, including monetary policy, must be rejected. The actions and decisions of monetary policy makers can only be judged in terms of their objective. Under the Treaty, that is unambiguously price stability. Any attempts, especially by the European Parliament, to “reinterpret” Article 105 of the EC Treaty in such a way as to suggest that price stability and growth are monetary policy objectives of equal status are quite misleading. On the one hand, that would impair the transparency of monetary policy, which would no longer be pursuing a single clear-cut objective, while, on the other hand, it would be dangerous in terms of democracy theory to leave the decision as to which of its two objectives it should pursue with priority to an independent institution. Both in terms of constitutional law and in terms of democracy theory, the independence of the central bank can be justified only by setting an unambiguous objective.

Overloading monetary policy with several objectives would also be risky in macroeconomic terms. Stability is the best contribution that monetary policy can make to fostering growth and employment. Additional growth potentials can be opened up by further budget consolidation and structural reforms.

Independence must not be impaired by accountability. Pursuant to Article 108 of the EC Treaty, the independence of the central bank is regulated unambiguously. That provision of the Treaty also applies, of course, to the European Parliament. The ECB must likewise be independent of the European Parliament.

The ECB’s ex post reporting requirements are regulated definitively by the EC Treaty (Article 113 (3)): “the ECB shall present to the European Parliament, the Council and the Commission, and also to the European Council, an Annual Report on the activities of the ESCB and on monetary policy in the previous and current year. The President of the ECB shall submit the Report to the Council and the European Parliament, which may carry out a general review on that basis. The President of the ECB and the other members of the Executive Board may be consulted by the responsible committees of the European Parliament at the request of the European Parliament or on their own initiative.”

In practice, the Eurosystem goes well beyond these Treaty obligations. Besides submitting the Annual Report to the plenary session of the European Parliament, the ECB President appears before the

European Parliament’s Committee on Economic and Monetary Affairs at quarterly intervals in order to expound the Eurosystem’s monetary policy. Other members of the Executive Board may also report to the Committee, and have already done so on specific topics.

In view of the ECB’s general willingness to cooperate with the European Parliament on this issue, there is no justification for any more far-reaching demands.

Monetary policy, the value of money, has deliberately been removed from national and supranational parliamentary control in order to keep money and the currency out of the purview of day-to-day politics and the clutches of pressure groups. This is a modification of the democracy principle for the sake of safeguarding the currency. In the current debate in the European Parliament, that fact should be recalled whenever there is talk of “democratic accountability”. In order to rule out politicians’ intervention from the outset, the responsibility for the monetary system was assigned to the central bank. That constituted an attempt to “de-politicise” monetary policy, to put it in the hands of experts who, thanks to their long terms of office, are independent of day-to-day political concerns and have to gear their policies to an objective.

These principles must be borne in mind whenever attempts are made to involve the ECB more closely in macroeconomic coordination in the euro area.

In order to preclude misunderstandings, the following should be pointed out:

Stability-oriented monetary policy must be buttressed by responsible economic, fiscal and pay policies to ensure the lasting success of EMU. Since those policy areas have remained national responsibilities, coordination is in the best interests of all those concerned, as I said at the beginning. In line with article 99 of the EC Treaty, member states therefore regard their economic policies as a matter of common concern. The functioning of EMU must not be jeopardised by the economic policies of individual member states.

Coordination is accomplished in an annual cycle, at the centre of which are the “Broad Economic Policy Guidelines”; they are adopted by the ECOFIN Council on the recommendation of the Commission and after discussion by the European Council. The broad guidelines define the main economic policy objectives and the basic policy orientations. EU member states are required under the EC Treaty to gear their economic policies to those guidelines.

Pursuant to the EC Treaty, the ECOFIN Council is the key coordinating body. It makes comments or recommendations to the member states, and may, if necessary, also publish them – as it did recently in the case of Ireland.

The enhanced coordination of economic and fiscal policies in the European Union (EU) is a serious and warranted concern of the ministers of finance. The EC Treaty specifies the procedures, instruments and institutions envisaged to that end. In addition, the informal Eurogroup was set up in 1998, composed only of the ministers of finance of the member states of the euro area, in order to intensify the exchange of views and coordination. The Eurogroup is, however, not a decision-making body. Pursuant to the EC Treaty, decisions can be taken only by the Council, which is made up of the ministers of all EU member states.

Thus, the Eurogroup has no formal duties. Even so, the debates held there and peer pressure emanating from that body are important and useful, especially in the national implementation of consistent fiscal and structural reform policy. This is why the Eurogroup should focus on that area.

The strengthening of the Eurogroup, which has been under discussion at the political level for several months now, and which has also been called for by the EU Commission, must be firmly resisted

– firstly, if the work of the Eurogroup is to be formalised, i.e. given an official status, and

– secondly, if the independence of the ECB is to be adversely affected.

The formalisation of the Euro group is incompatible with the role of the ECOFIN Council as envisaged in the EC Treaty. The independence of the ECB, in turn, is never called in question in public. But neither must it be undermined in effect by changes in the procedures, instruments and institutions of economic and fiscal policy coordination.

The Eurogroup is presumably to be strengthened primarily in its relations with the ECB. That would definitely be inconsistent with the provisions on EMU, especially those governing the independence of the ECB. The ECB has no need of any political corrective. All those bearing political responsibility today in Europe, including the EU Commission, must be reminded of the stipulation included in article

108 of the EC Treaty. In that, “the Community institutions and bodies and the governments of the member states undertake to respect the principle of independence, and not to seek to influence the members of the decision-making bodies of the ECB or of the national central banks in the performance of their tasks”. Hence coordination between monetary policy and other policy areas is out of the question. Likewise influence on the ECB through a so-called “triumvirate”. A glance at the Treaty would help to prevent false political ambition.

Already today, the dialogue between the Eurogroup and the ECB is intensive. It cannot and must not be transformed into coordination including monetary policy. The young currency euro needs political influence least of all. The much-vaunted “political visibility” of the Eurogroup exists. And yet, as I may recall at this juncture: the only spokesman for the euro is the President of the ECB. He is “Mr Euro”.

Any political attempt to involve the ECB ex ante in political decisions or to create a second “Mr euro” (namely, the Chairman of the Eurogroup) would only lead to a blurring of responsibilities and thus to confusion.

Conclusion

1. Right from the start, the ECB has demonstrated responsibility, reliability and consistency in its monetary policy. The ECB is close to its objective of safeguarding price stability, and keeping inflation below 2 % in the medium run. The inflation rate in the euro area is likely to drop back below 2 % in the second half of 2001. The ECB is pursuing its own strategy, geared to European conditions. Its decisions are based on its own analyses. It is not sailing in the wake of the Fed. Up to the present, it has pursued a policy of “steady as she goes”. Hectic responses by central banks transmit themselves to the markets and increase volatility.

2. The ECB must go on working to enhance its credibility and to strengthen the confidence of the markets and residents. To accomplish that, it is important to withstand political pressures and to defend the independence constitutionally enshrined in the EC Treaty against political “attempted embraces”. In this respect, the ECB should be less modest. It should be less reluctant to issue public clarifications whenever concealed attacks on its independence are concerned. That is to say, the ECB must be prepared, to a greater extent than in the past, to carry out conflicts with the European Parliament and the Eurogroup in public. The increasing political demands being made on the ECB must be met with greater self-assurance. Failing that, the young institution will run the risk of being forced on to the defensive in the event of a serious test.

3. Politicians are not doing themselves any favours by making demands on the ECB going beyond the Maastricht Treaty. Instead, the politicians should concentrate on the major challenges arising in their own fields of responsibility in order to ensure the lasting success of EMU. That means: the right order is to be given to the political agenda. Too many resources are going into the question of how fiscal and monetary policy can be coordinated to obtain the right policy mix, and to the question of who is to speak on behalf of the euro, and who is to represent the euro area vis-à-vis other countries and international institutions. Some politicians regard these questions as important – I have my doubts about their relevance. Answers to those questions are certainly irrelevant to the operation of EMU. The fact is: there is a Mr euro, the telephone number of the euro is known, and there is no common European economic policy; so a second Mr euro is not needed.

4. Instead, the politicians of the euro area should endeavour to continue their good approaches to the further deregulation and liberalisation of the markets, for instance in the energy market (where some rather disappointing signals are emanating from Stockholm) and to enhance the flexibility of the labour markets. Tax relief and reform of the social security systems remain on the agenda. As far as the Political Union is concerned progress has to be made. In this respect, the stage of intergovernmental cooperation must be overcome. The prospects of a lasting success of EMU will be improved if

– firstly, every country devotes itself in full to its own reform tasks,

– secondly, every institution performs to the best of its ability the duty assigned to it by the EC Treaty, and

– thirdly, the political integration process proceeds apace and the national egoisms become manageable and ultimately are overcome.