Prof. Tietmeyer discusses the Bundesbank's commitment to stability

Translation of an article by President of the Deutsche Bundesbank, Prof. Hans Tietmeyer, published in the Frankfurter Allgemeine Zeitung on 28/12/96.

In post-war Germany, there has been a broad consensus about the importance of a stable currency across all political groupings. The bitter consequences of two previous hyperinflations as well as the positive experience gained with the D-Mark and its strength played a major role in this.

In the recent past, however, the public debate has sometimes caused doubts to be raised concerning how far this consensus still goes. Admittedly, there have often been similar disputes in post-war history. One has only to remember the controversy surrounding the D-Mark appreciations in the sixties, when the relationship between internal monetary stability and external exchange rate stability first became an issue. Or the arguments in the seventies about the spurious alternative of more inflation or more unemployment. Ultimately, however, all these controversies did not seriously jeopardise the consensus on stability; if anything, they tended to strengthen it, in fact.

New discussion on stability

In the run-up to the introduction of European monetary union and against the backdrop of very sharp exchange rate changes in the first half of the nineties, the debate about the importance of monetary stability -- at least in some of its forms -- seems to have gained a new quality. For example, it is not only the trade-off between inflation and unemployment -- that had been thought to have been overcome -- which has been revived recently in a number of comments made by industry, the trade unions and politicians. In view of the degree of price stability achieved, adherence to a policy of non-inflationary growth is occasionally even brought into discredit as a deflationary policy. Perhaps even more frequently one hears the proposition that foreign exchange rate stability must purportedly assume priority over internal price stability -- exchange rate stability evidently meaning the nominal and not the real (price level-adjusted) stability of exchange rates. A sustained low external value of the D-Mark has not infrequently even been regarded as necessary (or at least beneficial) for the German economy, regardless of its implications for internal monetary stability.

In the recent past, this debate has also increasingly become part of the wider discussion about monetary integration in Europe. It is thus acquiring a new dimension, even going as far as postulating European monetary union at all costs; in other words, a monetary union which would tend to result in a soft rather than a strong euro. At any rate, there are a number of participants in the current discussion (in Germany, too) who -- without saying it so explicitly, of course -- evidently regard the changeover to the euro as a welcome opportunity of lessening the D-Mark's former external strength. The open or covert advocates of a weakening of the currency on competitive grounds obviously fail to recognise the interrelationship between internal and external stability. They overlook the fact that, in the past, Germany was regularly among those countries with the lowest interest rate level world-wide -- precisely because of the stability of its currency. That was and continues to provide a strong competitive edge which cannot be rated too highly, quite apart from the generally cost-curbing effects of monetary stability.

The fact that such depreciation strategies are at variance with the aim of the Maastricht Treaty and even more so with its interpretation by the Bundestag, the Bundesrat and the Federal Constitutional Court seems either not to be taken into consideration or to be deliberately accepted. The Bundesbank's adherence to internal monetary stability has led to it being accused of an undue stability policy bias, or even of being obsessed with stability.

Bundesbank in favour of a stability union

To avoid any misunderstanding: the Bundesbank is committed to the road to European monetary union laid down in the Maastricht Treaty. In the relevant bodies at national and European level it is collaborating intensively in solving the complex and by no means easy technical tasks involved -- these range from harmonising the hitherto very different monetary policy instruments in Europe, putting in place the organisational and legal framework for the European Central Bank and the euro, to a fundamentally new and modernised payment system. All this work should not be underestimated. The preparations have to be advanced to a stage which enables the European Central Bank Council to take decisions immediately after it has been established. The European Central Bank System has to be fully operational and functionally viable right from the very first day of monetary union. And the set of instruments then in force must not put individual banking groups at a disadvantage or jeopardise the benefits of the decentralised banking structure which obtains, particularly in Germany, and the dominant long-term orientation of the markets.

As important as this intensive collaboration in the technical preparation of monetary union may be, what is of even greater importance is the Bundesbank's public advocacy of monetary union actually becoming a permanent stability union, as is provided for in the Maastricht Treaty and is quite obviously desired by the majority of the population. Although there are occasionally slight differences of emphasis on individual points, there is complete unanimity within the Central Bank Council concerning the goal itself. Monetary union must become a permanent stability union with a strong currency, not least in order to prevent political conflict which might otherwise pose a risk at a later date. The Bundesbank is at one in favouring the creation of the economic and political preconditions which will ensure that the monetary stability gained through the D-Mark is likewise permanently maintained following the changeover to the euro. It has the authority to do this not only by virtue of the consensus on non-inflationary growth prevailing in Germany, it is also under a statutory obligation to do so. In accordance with article 3 of the Bundesbank Act it has the legal mandate of "safeguarding the currency". Moreover, in accordance with article 12 it "is required to support the general economic policy of the Federal Cabinet", but only without prejudice to the performance of its primary duty to "safeguard the currency". The Act explicitly states that the Bundesbank is independent of instructions from the Federal Cabinet in exercising its powers.

Priority of internal stability

However, the legal wording "to safeguard the currency" does not seem to be totally unambiguous with regard to the question of internal monetary stability having priority over exchange rate stability. At the time this law was drafted in 1957, when the Bretton Woods system of fixed exchange rates was still in force worldwide, internal and external exchange rate stability was virtually free of conflict. It was not until tensions emerged between the major industrial countries, as a result of domestic policy decisions and priorities drifting apart, that the subject of protecting internal stability policy against external constraints (as it was later called by Karl Schiller) became a matter of key importance. As the sixties progressed, the Bundesbank in Germany, with the vigorous support of the Federal Economics Ministers Ludwig Erhard and

Karl Schiller, committed itself more and more unequivocally to the priority of internal monetary stability. And that has remained the case to the present day, with far-reaching agreement between the Federal Government and the Bundesbank. The Maastricht Treaty even adopted the priority of internal stability expressis verbis, in fact. Maintaining price stability has been enshrined in article 105 as the primary objective of the European System of Central Banks. The Bundesbank's primary orientation towards internal price stability is hence fully consistent with the regulations which will apply one day to the European Central Bank.

The Bundesbank has to fulfil its stability mandate, as defined above, in several ways. Its first and most crucial task is to conduct its own monetary policy in line with its anti-inflationary stance. It does have to play its part in achieving the other targets of the Stability and Growth Act (high level of employment, external equilibrium and stable and adequate economic growth), but only to the extent that this does not jeopardise its primary goal of price stability. Since there is a large measure of consensus among economists that price stability is not -- at least in the medium term -- inconsistent with the other targets of the so-called uneasy quadrangle, but is, instead, a prerequisite for continued growth, high employment and external equilibrium, there should not actually be any conflict in this respect. An anti-inflationary monetary policy also serves other macroeconomic goals, the example of Germany providing ample evidence of this. Although a stable currency alone cannot automatically bring about and safeguard sustained growth and increased employment, it is an indispensable precondition for them. Furthermore, experience has shown that monetary stability also makes a major contribution to social equity. Given the demographic trends, not only in Germany but also in other European countries, this will be all the more the case in the future, since private provisioning by the "ordinary citizens" will become increasingly important.

Role as a guardian of monetary stability

In the final analysis, however, monetary stability cannot be safeguarded by an anti-inflationary monetary policy alone. It will always be influenced by the prevailing behavioural patterns in society and by developments in other policy areas. This applies, in particular, to those decisions taken in fiscal policy, labour market policy, social policy and wage policy which affect the viability of the economic and social system. Long-term undesirable trends in those areas also tend to jeopardise monetary stability in the short or long run, and then often require monetary policy countermeasures. For that reason, the Bundesbank's role as a guardian of monetary stability must of necessity extend beyond its decision-making powers in monetary policy. It has to draw attention -- at as early a stage as possible -- to potential risks to stability in other areas and parallel behavioural patterns in the economy or in society. The Bundesbank has always made every possible effort to do this, without interfering in the political discussion of specific details.

The Bundesbank is also especially suited to this more far-reaching function as a guardian of stability on account of the fact that the legislature has kept it largely free of day-to-day political influence and special party and lobby interests by virtue of its being independent of political instructions and by the long-term appointment of the members of its governing bodies. Being free of short-term party and special interests, the Bundesbank is hence able to raise its warning voice -- which it has always done in the almost forty years of its existence -- if it perceives the emergence of national or international risks to monetary stability.

However, the political independence of the Bundesbank by no means implies that it is free of responsibilities. In contrast to many other countries, it is not -- for well considered reasons -- accountable to the government or to parliament. Nevertheless, from the very beginning it has placed itself under the obligation publicly to explain and justify its policy as well as its assessment of developments that are relevant to monetary policy. Its target group is the general public which it addresses through the speeches of the members of its governing bodies and its diverse publications, especially its Monthly and Annual Reports. The Bundesbank uses all these opportunities to explain its policy and the reasons behind its decisions. It hence puts itself before the forum of public discussion.

Role of a monetary policy adviser ...

Furthermore, the Bundesbank has been assigned a specific advisory role vis-à-vis the Federal Cabinet by the legislature. In accordance with article 13, the Bundesbank has to “advise the Federal Cabinet on monetary policy matters of major importance”. This advisory role has often been quite significant in the history of the Bundesbank. It not only played a considerable part in all the discussions on the design and application of the international and European monetary system. At the request of the Federal Cabinet, the Bundesbank also advised it in connection with preparing for German monetary union. Naturally, the political bodies were and remain free to follow the advice given by the Bundesbank or not. In fulfilling its political responsibilities, the Federal Cabinet departed from the Bundesbank’s recommendations on individual points (e.g. in the selection of the conversion rate for current payments).

... in the Maastricht negotiations ...

The Bundesbank also performed its advisory function in connection with the negotiations on the Maastricht Treaty. As long ago as September 1990, the Central Bank Council drew attention to what it deemed to be the key issues in a memorandum. It said, among other things, “... the participating economies (i.e. in the monetary union) will be inextricably linked to one another in the monetary field, come what may. The implications of this -- especially for the value of money -- will depend crucially on economic and fiscal policy and on the stance of management and labour in all member states.” And then the indispensable benchmarks of a successful stability union are spelled out in detail: from an independent central banking system, with a priority commitment to the target of price stability, via the regulations for lasting budgetary discipline, to the requirements for sufficient and durable policy convergence among the participating countries prior to entry into the final stage.

In addition, Bundesbank representatives, through their work on the EU Monetary Committee in Brussels and on the erstwhile Committee of Central Bank Governors in Basle, contributed to the wording of the Maastricht Treaty in numerous instances. For example, the statute of the European Central Bank was drafted largely by representatives of European central banks in Basle and then adopted, virtually unchanged, by government representatives in the Treaty negotiations. Parallel to the negotiations in Brussels and Maastricht, there were of course also repeated bilateral talks between the Bundesbank and the Federal Government on major aspects of the Treaty.

These intensive and close contacts were and are fully in line with the Bundesbank’s statutory mandate to proffer advice. Equally, attention should be drawn to the fact that this does not affect the Government’s political accountability. It was not and is not the

Bundesbank that conducted or conducts negotiations itself on these subjects. Incidentally, neither was it the Bundesbank that was responsible for the numerical fixing of the so-called fiscal criteria at 3 % of GDP for the current budget deficit and at 60 % of GDP for the fiscal debt level. To my knowledge, both figures, which in the eyes of the Bundesbank tend to be too generous, rather than too strict, for most countries, were put forward by delegations other than the German one. In the joint estimation of the Central Bank Council, however, it is imperative that, prior to entry into monetary union, “the budget deficits in all the participating countries should be reduced to a level which is sustainable in the long run and unproblematic in terms of anti-inflation policy requirements”.

After the conclusion of the Treaty negotiations, the Central Bank Council published the following evaluation of the Treaty early in 1992: “The question of whether EMU is to be established is a political decision. ... The planned institutional design of the final stage is largely in line with the Bundesbank’s recommendations. In particular, the statute of the future European System of Central Banks ... It will be of paramount importance for the overall success of the envisaged economic and monetary union that the Community decisions to be taken in ... 1998 on the selection of the countries eligible for participation should be geared solely to their stability policy performance.”

... in the preparations for EMU

In line with its statutory mandate, the Bundesbank is also advising the Federal Government in the current negotiations on the preparation of monetary union. That applies particularly to the consultations on the legal texts for what is known as the “secondary legislation” now taking shape in Brussels. And it also applies to the proposal for a European stability pact (which was put forward by the Federal Government and backed by the Bundesbank) to concretise the surveillance process for budgetary and debt trends in the participating countries envisaged in article 104c of the Treaty. That stability pact has nothing to do with any German desire for hegemony. Instead, it is intended to prevent potential conflicts from arising between the future single stability-oriented monetary policy and fiscal policy (especially the fiscal policies of the major member states), thus protecting the smaller member states, in particular, from hardships imposed by the potential misconduct of the larger ones.

Urging “strict” compliance with the contractual convergence criteria in the selection decision by the European Council on the member states participating in the monetary union beginning in 1999 -- as reflected in the evaluation of the Treaty published early in 1992 -- is, after all, part of the Bundesbank’s function of being a guardian of price stability and advisor. The calls made by the Bundesbank -- incidentally, in complete agreement with the Federal Government -- for a “strict” interpretation of the criteria laid down in the Treaty are by no means merely legalistic. Just like the Bundestag and the Bundesrat, the Bundesbank regards strict and lasting compliance with the convergence criteria as an essential precondition for the smooth inception and, as far as possible, conflict-free continuation of monetary union.

Lasting convergence indispensable

References to the fact that today there is not infrequently divergence, rather than convergence, within existing monetary areas disregard the fundamental difference that obtains between a monetary area that is identical to the borders of a nation state and a monetary union, which comprises several nation states with a different regulatory and social systems. After all, in a monetary union extending beyond the frontiers of a single nation state, the common features and compensatory systems which regularly exist within a nation state (such as a common legal and tax system, a dominant central government budget, common social security systems and fiscal adjustment mechanisms) are missing. Hence in a monetary union composed of several member states without superordinate national ties, the potentially diverging forces are far greater than in a nation state. It would be a fallacy to suppose that a common central banking system alone can prevent potential divergencies in a union comprising several major member states. This is why a monetary union encompassing several nation states entails from the outset a high level of common "stability culture", in the sense of joint preferences and tried-and-tested capabilities. The degree of lasting convergence achieved and the readiness to maintain lasting financial discipline are intended to document precisely that. Disregarding the significance of the selection criteria and lastingly failing to acknowledge it would imply a lack of strategic perceptiveness, and not vice versa. A monetary union which later turned out to be particularly conflict-prone, let alone fragile, would not only pose economic problems, it might even turn out to be a serious threat to the European integration process. Drawing attention to these far-reaching political dangers, and thus to the crucial importance of selecting countries in keeping with the criteria, is undoubtedly part and parcel of the Bundesbank's advisory mandate. After all, the monetary union must not be allowed to fail, let alone to become a source of political conflict in Europe.

Not a "state within the state"

All in all, the Bundesbank has constantly endeavoured to perform its role of being a guardian and advisor in keeping with its stability target, as laid down by Parliament -- and it will continue to do so. In the basic orientation of its policy it knows at the same time that it enjoys a consensus with the vast majority of the population. The performance of these duties by the Bundesbank, like its monetary policy, which is geared primarily to domestic price stability, has nothing to do with any stance as a "state within the state". Nor does it have anything to do with a desire for German hegemony in Europe. Quite the contrary, a lastingly sustainable foundation and an anti-inflationary orientation of the monetary union are without any doubt in the best interests of Europe, too.

It may well be that such a stability-oriented guardian and advisor function does not always fit in with the political and tactical aspirations of the political decision-makers. That may even be true at times of our trading partners. But Chancellor Kohl rightly said publicly not long ago: "As the Federal Chancellor, I sometimes have problems with individual measures or statements by the Bundesbank. But as a citizen of this country, I am happy that the Bundesbank exists and that it acts in this way. Of course, neither the Bundesbank nor its President can claim always to take the right action in all circumstances".

On taking office in 1993 I said: "Even the Bundesbank is not faultless". Needless to say, that is just as true today, and will remain so in future. But the fact that the Bundesbank is attested a substantial measure of "credibility in anti-inflation policy" in Germany, in Europe and in international circles alike has certainly done Germany and Europe as a whole more good than harm. That verdict has been confirmed time and again by impartial observers. Hence the Bundesbank will also continue to feel itself committed to stability in the period ahead.