

Mr. Duisenberg discusses the comparisons between the structures and methods of the European System of Central Banks and the US Federal Reserve System

Address held by the President of the Netherlands Bank and of the Bank for International Settlements, Dr. W.F. Duisenberg, at the Spring Meeting of the Institute of International Finance in Washington on 29/4/97.

1. Only twenty months to go before EMU takes off; before then, in the summer of 1998 at the latest, the ESCB will be established. The preparations for this turning-point in the history of Europe are in full swing. Next year it will be decided which Member States are to be in from the outset, a decision to be taken as you know by the Heads of Government on the basis of the measure of sustained convergence achieved. Although the stability-oriented tradition which has grown up over the years is to be continued within EMU, there will be a fundamental change in the way monetary policy will be determined centrally. Here questions arise, such as: how will the centre, i.e. the ECB, and the existing national central banks relate to each other in such a context, and how can the skills and expertise of those national central banks best be used, without impairing the single nature of monetary policy? It is these questions that I would like to focus on today. As the ESCB will have a federal structure comparable to that of the Federal Reserve System, it may be useful to take a look at the experience of the United States, all the more so as the underlying economies will be comparable in size. In particular, what lessons can Europe learn from this experience?

2. Let me emphasize a few points at the outset. On its own, monetary policy is not equipped to counter an unfavourable macro-economic development. That calls for the concerted employment of all available macro-economic policy instruments. In the American situation, the Fed is expected to operate within the framework of the general economic objectives set by the Administration. Coordination is facilitated by the centralized formulation of monetary policy. In a monetary union such as the United States and the future EMU, policy can only be pursued centrally. It is indivisible by its very nature, for one thing because of its official interest rates, subjecting all regions making up the union to uniform financial conditions. As to the question how monetary policy can best be conducted, there is no unequivocal answer. That question relates to issues such as the economic variables on which policy should focus, or in other words, the choice of intermediate objective. In some countries, Germany among them, policy is targeted at a monetary aggregate, while in others a strategy of direct inflation targeting is pursued. Alternatively, monetary authorities may focus on a range of economic indicators, as is done in the United States. I will not go into the pros and cons of these methods here today. In the European context, the EMI has concluded that in practice the differences between the various policy strategies that could be pursued by the ESCB are not as large as in theory. A decision is to be taken by the ECB on this point next year.

3. Looking at the structure of the Fed, we see three components, specifically the Board of Governors, the regional reserve banks and the Federal Open Market Committee (FOMC). The FOMC issues a periodic guideline for monetary policy, while the Board serves as the executive body. It is empowered to adjust policy, within the mandate provided by the FOMC, when necessary in the period between FOMC meetings. Thanks to a rotation system, the reserve banks are involved in FOMC decision-making on an alternating basis. The American legislature obviously meant the Fed to have a decentralized structure, in which the regional reserve banks can each have their say. The aim was to prevent Fed policy-makers from catering unduly to the wishes of either the financial centre, i.e. New York, or the political hub, i.e. Washington. In spite of the decentralized nature of the Federal Reserve System, however, a certain specialization tendency has increasingly developed over the years, due in part to technological innovations and market developments. Take, for instance, the operations ensuing

from the Fed's monetary tasks, such as money and foreign exchange market interventions. These are effected in their entirety in New York. In other areas, too, such as the payments system, the reserve banks have developed their own specializations.

4. In determining monetary policy, the Fed relies on regional input. The reserve banks contribute to policy through their role in the discussions and the number of votes they can cast (five out of a total of twelve) at FOMC meetings. At these meetings no fixed policy proposals are presented in advance, the aim being an open discussion where the various parties reach agreement through mutual persuasion. Any decision should, after all, be endorsed by as many parties as possible. Obviously, in this American context, the chairman must be someone of considerable stature. I believe that involving the reserve banks in policy-making and in the efforts to expound that policy to the folks back home is the right way to go about things, reinforcing as it does the cohesion within the system.

5. In short, the Fed operates what is in my view a well-balanced model of monetary decision-making. Though policy is conducted centrally, the various interests of the separate regions are not overlooked. The System is furthermore capable of reacting adroitly, as evidenced by the United States' long-term record of strong economic growth and modest inflation.

6. How does everything I have just said translate to the future situation in Europe? As in the United States, policy in Europe will be determined centrally and implemented, where possible and appropriate, decentrally. In Europe, too, an institutional division into three components will be instituted. Specifically, the ESCB will be made up of three elements, the ECB Executive Board, responsible for day-to-day policy, the ESCB Council, made up of this Board and the governors of the national central banks, and the national central banks themselves. There are considerable similarities between this structure and that of the Fed, made up of the Board of Governors, the FOMC and the reserve banks. Yet the emphasis will, on some issues, be placed differently.

7. One difference concerns voting arrangements within the ESCB Council, which are not the same as those within the FOMC. In the ESCB Council the votes of the national central banks, represented by their governors, will predominate over those of the Executive Board. In the FOMC, it is the votes of the centre, i.e. the Board of Governors, which represent the majority. This means that if effective decisions are to be arrived at in Europe, the national central bank governors will have to be like-minded; in other words, policy-makers will have to abandon their purely national outlooks, exchanging them for a "European perspective". The experience of the FOMC shows that this can be achieved. The ESCB will have the important task of helping to foster such a European perspective, with the centre taking the initiative. The European outlook will furthermore have to be disseminated among the general public. An ESCB making an effort to explain and seek understanding for its policy decisions will generate support for its actions. This is a task for the national central banks, whose historical ties to their own peoples are deeply rooted. In this respect it should also be kept in mind that the Fed's accountability to Congress has no equivalent in Europe. Although the President of the ESCB is expected to appear periodically before the European Parliament, the latter does not have the same powers as the US Congress, which can in principle amend the Federal Reserve Act. Furthermore, any discussion of the European policy mix will be different in nature because budgetary policy will remain the province of the European Member States. This policy will, however, be subject to the limitations set out in the Stability Pact recently agreed by the Member States, which as you know aims to foster sustained sound public finances in Europe.

8. What I have just said about the need to develop a “European” perspective has implications for monetary and economic analysis. The centre will need to have at its disposal considerable analytical machinery in order to be able to perform this pioneering role successfully. As a system of European statistics and analysis cannot be set up overnight, no time should be lost. Indeed, the preparations being made at the EMI in this area are proceeding at full steam. Of course, these new statistics will take getting used to. But, at the same time, some things will remain unchanged. National analyses will continue to play an important role so long as Europe has not been transformed into a single economy. After all, if we wish to understand what is happening at the European level, we would be well advised also to look at the underlying national economic relationships. With respect to these analytical tasks, the division of labour between the centre and the national central banks is likely to evolve of its own accord. At first glance, this division seems likely to reflect that the national central banks know their own economies best.

9. Contrary to the US situation, the implementation of monetary policy in Europe will not take place at one location away from the centre but, where possible and appropriate, decentrally. That has to do with the fact that Europe’s central banks and financial markets have a rich and extensive history. A decentral approach makes allowance for differences in European practices and market conditions. In this context it should be noted that the formulation chosen for decentralization in Europe in principle allows for the ECB to play a role in policy implementation. There is no knowing in advance how the tasks will be divided among the national central banks themselves, and between them and the centre in the more distant future. The American example shows us that such matters cannot be laid down in a blueprint for eternity. Decentralization is a sound principle to cater to initial national differences in the financial markets, but it must not stand in the way of further integration. In other words, policy must accommodate the disappearance of national financial market characteristics and the emergence of a single integrationa European money and capital market.

10. EMU will remain a union of different countries. This means, among other things, that the differences prevailing among the various central banks regarding their non-monetary tasks can, in principle, continue to exist. I am referring here, for instance, to banking supervision, surveillance of payment systems, and the fiscal agent function for the benefit of the Government. It is interesting to see that in the United States, where such matters have been organized in a uniform manner, some degree of specialization has emerged among the regional reserve banks. Owing to the continuing existence of national responsibilities and practices, this extent of specialization will not be feasible in Europe.

11. I have arrived at the conclusion of my address. Like the Federal Reserve System, the ESCB will be characterized by central and decentral elements. However, the mix will not be the same, due to differences in the starting position, as well as in social and political conditions. Yet the experience of the Federal Reserve System offers instructive insights. It highlights the importance of “homogenous” thinking within the system, and of focusing on the European perspective, without disregarding regional developments. It will be a challenge for us in Europe to ensure that a similar balance is achieved within the ESCB.