

Mr. Tietmeyer asks whether the euro can assume the role of a major international currency Speech given by the President of the Deutsche Bundesbank, Prof. Hans Tietmeyer, at a luncheon at the American Express Company in Paris on 28/10/97.

I.

The “American Express Company” is not only a financial institution, but also a brand-name familiar throughout the world. The “American Express credit card” and “American Express travellers’ cheque” are acknowledged in most countries as safe and convenient means of payment, which facilitate not just travel. For decades past, therefore, “American Express” has been a symbol of increasing globalisation. There are not many other enterprises that can claim that.

Today, however, I do not want to talk about payment instruments. Even so, my reference to the travellers’ cheque takes us straight to our topic: alongside the “greenback”, the travellers’ cheque is likewise a symbol of the dollar’s status as the absolute Number One among the currencies of the world.

II.

A currency which serves at the same time as a unit of account, a medium of exchange and a store of value -- for private investors and public monetary authorities alike -- is known as an international key currency.

What are the pre-requisites that a national payment medium needs, in order to assume these functions?

Monetary history teaches us that the international role of a currency may often develop spontaneously with the country’s political and economic significance. Hence it is not surprising that, besides gold, the pound sterling played the overriding role in the international monetary system for many decades. A well-functioning banking system and efficient capital markets had evolved in the United Kingdom at an early date. The industrial revolution began in Great Britain, and helped the British economy to gain an edge over all other countries.

The role of sterling was primarily based on the UK’s position as a great power, in both economic and political terms. What is more, over a period of two centuries sterling did not depreciate against other currencies. Once the significance of sterling started to decline, the dollar took the stage as the principal international currency. This was due not only to the US’ rise to the status of a world power. Another important factor was that, for a long period, the dollar was far less exposed to inflationary pressures than other currencies.

By virtue of the Bretton Woods system, the US dollar became the official key currency in 1944. It served national central banks as a benchmark currency, an intervention currency and a reserve currency alike. Following the collapse of the Bretton Woods system, and given the domestic stability problems in the United States, the dollar forfeited that formal function.

Even so, it retained a leading role. As before, the United States remains the world’s leading industrial and trading nation. That is why dollars are so highly acceptable worldwide. Moreover, the magnitude of the US financial market ensures a wide variety of investment options.

The decontrol of exchange rates, the increasing freedom of capital movements and diverging stability records are the reason why other currencies, such as the Deutsche Mark, have been

able to establish themselves alongside the dollar -- albeit on a far more modest scale. After all, currencies, too, compete to an increasing extent for the favour of the international transactor.

Besides economic significance, a dynamic economy and a sufficiently large economic area (duly integrated in world trade), it is primarily monetary conditions that must be met. An international key currency must be able to exhibit a successful stability record over a lengthy period. While the markets may forgive short-lived slips, long-term failures are penalised. The markets' memory often stretches back a surprisingly long way. They heed the faintest signs that a currency's stability may be at risk.

It is that which makes the credibility that the responsible monetary authority enjoys all the more important. It has transpired that such credibility increases with the degree of independence from government instructions. If a central bank has to serve two masters, namely monetary stability and the promotion of economic activity, it usually comes to grief in both areas. Then its credibility is compromised for a long while.

III.

The introduction of the euro marks a watershed, not only for the monetary situation in Europe but also for the global monetary system. Little more than a year before its planned introduction, the world's financial markets are now wondering: will the new currency be strong or weak? Can it become a serious alternative to the dollar as a reserve, investment and transaction currency?

In Europe, great economic and political hopes are being pinned on the euro. The old continent is to be strengthened as a global economic power, European integration is to be fostered. It is hoped that it will be possible to cope more effectively with the challenges posed by globalisation. Moreover, many people are hoping that the euro will constitute a significant counterweight to the pre-eminent dollar. That is what Jacques Chirac, the French President, said recently in an interview he gave to a German news magazine.

But the crucial factor will be whether the euro turns out to be sustainably stable, and what the market expectations in that respect are. The institutional conditions for a stability-oriented monetary policy in Europe are pretty well assured, thanks to the Maastricht Treaty and the independent central bank envisaged therein. However, a good deal will also depend on the appointments to the Executive Board of the European Central Bank. Independence chiefly means the independence of individuals.

Among the European central bank governors in the European Monetary Institute, there is a broad consensus today about monetary policy objectives and strategy. That consensus must be preserved in the European Central Bank. That applies also to the view that internal stability has priority over external stability. The external value of the euro is inseparably associated with the precondition of internal stability: "stability begins at home". But the crucial event for the new currency will be the convergence examination in the spring of 1998, and the selection of the participating countries.

Only countries with virtually identical stability orientations and sufficiently sound public financial positions right from the start can accede to a durably stable monetary union. The selection of the participating countries is therefore a matter of paramount importance. The vital issue is the sustainability of the convergence achieved and the necessary adaptability of the participating economies to the constantly changing challenges. In this connection, special attention will be focused on Germany and France, since monetary union is almost inconceivable without the participation of either of these countries.

However, the task of achieving and maintaining convergence in anti-inflation policy does not apply merely at the time of entry into monetary union. Even after that, the policy mix must be right. This is because, in the monetary union, we shall be pursuing a single monetary policy, but at the same time largely national economic, financial and social policies.

When adopting the Stability and Growth Pact in Amsterdam in June 1997, the participating states undertook “immediately to take corrective budgetary action if there are signs of any considerable departure from the objectives of the stability and convergence programmes, and particularly from the medium-term budgetary target of a nearly balanced or in-surplus budget, or if an excessive deficit is in prospect.” That is a far-reaching undertaking.

In the event of excessive deficits, the Stability and Growth Pact provides that the European Council should automatically impose sanctions. The sanction mechanism is designed not only to foster confidence but also to protect the single currency from unbridled public deficits and to prevent conflicts between monetary and fiscal policy. It sets strict limits to national financial policy.

IV.

An international key currency generally has to assume the function of an anchor currency. The markets expect it. In the present EMS this function has been, and is being, performed by the Deutsche Mark. In the case of EMS II, the exchange rate arrangement for those countries which are not participating in the single currency from the outset, the euro is to perform this function of an anchor currency.

Furthermore, in future a strong orientation towards the euro is to be expected, particularly in central and eastern European countries. The euro will exert a strong attraction, especially on potential candidates for admission to the monetary union -- at any rate, if it proves stable.

V.

In themselves, however, the future larger economic area and credible compliance with the convergence criteria will not guarantee that the euro actually, and above all globally, develops into a serious alternative to the dollar. Ultimately, the real economic environment in Europe must likewise be right. The former Chairman of the Executive Board of the Deutsche Bank, Alfred Herrhausen, once said: “A currency becomes good if its underlying economy is also good”.

At present the European continent is being handicapped, above all, by the high degree of official regulation and the manifold inflexibilities on the labour market. In Germany, in particular, a confusing tax system with a high tax ratio is crippling economic dynamism. With respect to competitiveness, if Europe’s economy loses touch with other regions in the long run, this is bound to have adverse effects on the euro as well. At all events, the euro will not in itself solve the structural problems besetting Europe.

Worldwide locational competition calls for flexibility and the willingness to undertake structural reforms. Nowadays these characteristics are distinctly more marked in the United States than in most European countries. But there are some examples, on the old continent as well, which warrant hope.

VI.

In some quarters, the planned European monetary union is being viewed with concern through American eyes. That is understandable, for a soft euro -- let alone a failure of the monetary union -- is in the interest neither of Europe nor of the United States.

But there are a number of reasons for hoping for a stable euro that can play a leading role in the international monetary system:

- In Europe international investors find sophisticated financial markets encompassing a broad range of products and maturities. Structural changes in the international financial markets over the last fifteen years have worked to the detriment of the dollar. They have resulted in a rising market share of European currencies.
- Given roughly equal economic potential, the European Union is more closely integrated in the international division of labour than the United States. That suggests that the demand for euros as a transaction currency will be strong.
- The European Central Bank will be independent of political instructions. It is committed solely to the priority of internal monetary stability.
- The potential for excessive budget deficits is strictly limited by the Treaty of Maastricht and the Stability and Growth Pact.
- The Maastricht Treaty has noticeably fostered stability-consciousness in Europe. Inflation performance here is better than ever before. Only countries which can show evidence of long-standing stability are supposed to participate in monetary union.
- The euro can take up the torch from some illustrious currencies. That applies particularly to the Deutsche Mark -- today the world's second biggest reserve currency, after the dollar.

Of course, ultimately the development of the euro will hinge on whether it proves lastingly stable and to that extent can assume the legacy of those currencies which are already stable today. But all those involved are quite convinced: the euro has to be a success.

Despite all the headway made up to now, however, a great deal remains to be done. In the forefront are the sustained consolidation of public finance and the dismantling of structural rigidities. I am sure these needs are increasingly being recognised.

Anyway, there is certainly a good prospect of the euro duly playing its role of being an international investment, reserve and transaction currency alongside the dollar. That is, after all, in the best interests of Europe, the United States and third countries alike.