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A First Evaluation of the Institutional Framework for European Monetary Policy*

1. Introduction

The creation of the European Monetary Union (EMU) was a unique event in history: eleven countries gave up essential competences in the field of monetary policy in order to introduce a single common currency, called Euro. While the European Central Bank (ECB) was established, the national central banks did not disappear. On the contrary, all central banks of EMU had to be granted institutional independence. Together with the ECB, the national central banks (NCBs) of all EU member states constitute the European System of Central Banks (ESCB). The NCBs of the EU countries that have adopted the Euro and the ECB constitute the so-called "Eurosystem". The governors of the NCBs of the Eurozone and the members of the Executive Board of the ECB define the monetary policy in EMU. The policy is implemented by the latter and by the NCBs. So, the conduct of the European monetary policy is highly complex.

According to the Treaty on EC, the primary objective of the ESCB is to maintain price stability. But generally, even independent central banks do not conduct monetary policy without taking other economic objectives like high employment into consideration. The outcome of monetary policy depends to a great extent on fiscal policies pursued in a country. In countries like the USA or Japan, the central bank has to communicate with <u>one</u> fiscal authority that is responsible for a large share of public expenditures and tax receipts. In EMU, the budget of the European Community is negligible; about 98 per cent of governments' expenditures are spent by national or even subnational bodies (OECD, 2000, 73). So, in Euroland, the European monetary authorities must deal with at least eleven independent fiscal authorities. How can the fiscal interests of the EMU member states be channelled?

At first sight, the Economic and Financial Council (ECOFIN) seems to be the ideal body. But this solution ignores the fact that this council is composed of finance ministers from all EU member states, regardless whether they take part in EMU ("ins") or not ("outs"). The framers of the Maastricht Treaty presumed all EU member states to join the monetary union sooner or later. Thus, no official political institutions were established consisting of EMU member states only.

The ECOFIN council is important for the ESCB not only because of the possible coordination between monetary and fiscal policies. It is also an essential legislative body, deciding e.g. on secondary law concerning monetary instruments (such as the regulation on minimum reserve requirements). It is empowered to take decisions in the field of exchange-rate policy and of the movement of capital flows between the EU and third countries. The adoption of a formal ex-

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change-rate arrangement and measures taken to restrict international capital flows have great influence on the scope for monetary actions to be taken by the Eurosystem. Thus, the ECOFIN council, too, can be seen as an important part of the complex European monetary architecture.

The institutional framework for monetary policy in Euroland consists of various elements: The Treaty establishing the EC, the Statute of the ESCB and the ECB, legal acts adopted by the ECOFIN council and the ECB, as well as formal and informal rules observed by the decision-making bodies. As already mentioned, the conduct of monetary policy depends also on other policies such as labour market policy, wage policy and fiscal policy. In the EU, these policies are often implemented by national and subnational institutions. Labour market rigidities, wage inflexibilities etc. could also be seen as part of the institutional framework for European monetary policy.

I will confine myself to institutional aspects concerning the design of the ESCB, to questions with regard to an appropriate political counterweight to the ECB, and to the relationship between the ESCB and the political decision-making body ECOFIN (or its sub-body Euro 11). There are several reasons for this confinement:

(1) The impact that e.g. rigidities on labour markets have on monetary policy is less direct than the impact of e.g. exchange-rate policy.
(2) Most fields of economic policy remain in the competence of member states and cannot easily be regulated on Union level.
(3) According to some critics, the institutional framework even in a very narrow sense shows many faults, which are inter alia blamed for the external weakness of the European currency.[1)]

2. Institutional Problems inside the ESCB

2.1. Size and Composition of the Governing Council

The Governing Council of the ECB is the primary decision-making body in the field of monetary policy in EMU. It comprises the six members of the Executive Board and the 11 (soon 12) governors of all national central banks of the ins. Compared with the Open Market Committee of the US Fed, the number of members in that body is fairly high. According to some ECB watchers, the size of the Governing Council is already too large for free discussion and effective decision taking (Favero et al., 2000a, 70). Willem Buiter (1999, vii, 20), a former member of the Bank of England's Monetary Policy Committee, proposes to restrict its size to no more than nine members, no more than four of them belonging to the Executive Board. But members of the Governing Council such as the President of the Netherlands Central Bank, Wellink, do not see any problems even enlarging this body up to 21 persons in the case of an expansion of EMU to the outs and find even 25 members acceptable, when some Eastern European countries will join the monetary union (Tigges, 2000, 11).

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1 See Coppel et al. (2000, 5 f.) for several measures of the Euro effective exchange rates.

Closely connected with the size of the Governing Council is the composition of this body. According to the Treaty, the governors of the NCBs are not representatives of their countries, but have to act in full independence. No institution is allowed to give any instructions to the governors when they are exercising their tasks as members of the Governing Council. Each of them has - like each of the members of the Executive Board - one vote. Critics of this structure see the danger that the governors of NCBs try to pursue national interests (Begg et al., 1998, 4 ff.). The latters outnumber considerably the members of the Executive Board, who are assumed to pursue EMU interests. So, there is an asymmetrical power structure: the Executive Board as the centre of the Governing Council and of the ECB is weak, while the governors of the constituent NCBs are strong. The monetary policy might be dominated by national interests. Then, the Executive Board primarily has to execute the decisions taken by the Governing Council, and to a lesser extent to initiate and prepare those decisions. Furthermore, the Governing Council can also decide on proposals introduced by the Governors of the NCBs. Unlike the European Commission, the Executive Board does not have the exclusive right to initiate policy measures (Bini Smaghi, Gros, 2000, 7). Because of conflicts between national interests, inertia in policy formulation is seen as a consequence of the power-sharing inside the Governing Council (Begg et al., 1998, 5). The position of the NCB governors is strengthened by the frequent meetings of the Governing Council. It meets every two weeks, while the Statute of the ECB demands at least ten meetings a year only. So, there is much less need to delegate certain powers to the Executive Board. The continuing lack of current statistical data on a European (or better: Euroland) level (Kuls, 2000, 15 f.) contributes to an information asymmetry, which further weakens the Executive Board's position in relation to the NCB governors, who know national data.

The argument that NCB governors pursue national interests when taking decisions on the Governing Council is opposed by many central bankers and economists. Empirical evidence shows that even those who demanded excessive monetary policy to reflate the economy when they were members of the government, generally change their mind on becoming a member of a central bank (Jochimsen, 1999, 52). So it can be expected that the NCB governors in the ECB Governing Council refrain from pursuing national interests as well as in Germany or the USA, where the governors from the regional central banks do not (in the case of Germany: did not) subordinate the economy-wide goals to specific regional interests. This being conceded, critics assert that the regional adherence of, e.g., a governor of a Fed district bank in the USA is far less distinct than the national adherence in Europe (Begg et al., 1998, 6). But the "Becket effect"[2)] may nevertheless occur because members of a decision-making body take into account how their voting is perceived by the other members. So, the pursuit of national interests is less likely to occur. And even outspoken euro-sceptics must concede that NCB governors have voted more than once on the Governing Council against the interests of their home countries and in favour of the

2 This term stands for the influence which an institution exerts on new members to identify themselves with the interests of the institution.

interests of the Eurozone as a whole (Shirreff, 2000, 102). But the no-decision taking or the late-decision taking might be regarded as a pursuit of national interests, too. Up to now all decisions of the Governing Council seem to have been taken on the consensus principle, although it is criticized even by members of the Board (Padoa-Schioppa, 2000). And obeying this principle might give even more weight to employment and growth goals: Some NCB governors, having those goals in mind, tend to agree immediately with proposals to lower interest rates. They agree with proposals to raise interest rates only when inflation pressure has already increased considerably. In the spring of this year, it was criticized that a raise in interest rates was delayed, weakening or at least not strengthening the external value of the European currency. This can be regarded as a kind of export promotion policy, which is advantageous to some countries like Italy, where many firms compete with suppliers from outside EMU (Berni, 2000). But it is also possible that the NCB governors overemphasize the anti-inflation goal (Bini Smaghi, Gros, 2000, 14 f.). Even those from countries known as inflation-prone in the past now give high priority to that aim and cast their votes for raising interest rates when inflation pressure is high in their home country,[3)] even if price stability is achieved in the EMU area as a whole.[4)] Until now, it is impossible to observe the priorities of the NCB governors, for the minutes of the ECB meetings are not published. In either case, at least for some periods, national interests seem to have the upper hand over Eurozone interests.[5)]

That is why changes in size and composition of the Governing Council are repeatedly demanded in order to strengthen the Executive Board. According to the "counter-centralization proposition" of von Hagen/Süppel, the monetary policy decision-making body should be centralized due to the fact that fiscal and political power in EMU is highly decentralized (von Hagen, Süppel, 1994, 779). Some observers prefer a majority of the Executive Board members in the Governing Council like in the Fed (e.g. Begg et al., 1998, 8), others want only to reduce the majority of the NCB governors (e.g. Buiter, 1999, vii). In both cases, not all national central banks, which are constituents of the ESCB, would have a vote in the Governing Council. This would involve the introduction of revolving terms for NCB governors, like those of the governors of district banks in the US Fed. However, especially in EMU there are some reasons for a sort of representation of all member countries in the ECB's Governing Council. There are still differences in the financial structures in Europe (OECD, 2000, 63 f.), which should be taken in consideration when the appropriate monetary policy is discussed. And the rate of acceptance of the new single common currency might be lower in countries which are not represented in the

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3 Often in contrast to statements of the government in those countries.

4 In both cases, whether pursuing high employment or low inflation, national interests determine the voting, regardless of the economic situation in the EMU as a whole. This is compatible with many models, which show that a centralized power structure with a dominant Executive Board may lead to a lower degree of volatility in interest rates in the case of asymmetric national shocks (Begg et al., 1998, 6).

5 National interests are not unimportant for macroeconomic matters only. They might also be relevant for microeconomic topics as fixed rate versus flexible rate tenders (The Economist, 2000c).

Governing Council when Euro-notes and Euro-coins are introduced. Above all, the Treaty on EC would have to be revised to abolish the principle that each EMU member has one seat in the Governing Council. And that seems very unlikely to happen.

But the power of the Executive Board in formulating and conducting monetary policy in EMU could be strengthened compared with the current situation without any revision of the Treaty or the Statute. According to the Statute, normally a simple majority is sufficient when taking monetary policy decisions. If it can be assumed that the Executive Board members vote unanimously and a third of the NCB governors share their opinion, then the Executive Board is able to carry through its policy plans not only under the present circumstances, but even in the case of an EMU enlargement up to 20 countries. Replacing the consensus principle with the majority principle would also contribute to a faster decision taking. Many euro-critics reproach the ECB for having acted too slowly in raising and lowering interest rates.

The crucial question is, why it can be assumed that at least a third of the NCB governors approve the proposals of the Executive Board, which would be necessary to outweigh the Board's minority. The Executive Board is supposed to vote on EMU average economic data. Even when it is assumed that no NCB governor pursues the interests of EMU as a whole, but pursues his national interests, it can be expected that the governors of countries with a national macroeconomic development like that of EMU average tend to support the Executive Board. But the macroeconomic development in EMU is still dominated by a few countries, so one cannot be sure that the depicted scenario will occur. The weighted average of national economic data, representing the true economic development of EMU, when the weights are chosen in respect of the size of the member states, might diverge considerably from the simple average of national data, the latter average corresponding to the one-member one-vote principle in respect to the NCB governors (Bini Smaghi, Gros, 2000, 14 f.). And even if the majority principle is applied, it is hard to believe that decisions are taken with a small majority (e.g. 9:8). Besides that, there might be policy decisions which give the economic developments in some countries excessive weights (Favero et al., 2000a, 38), perhaps because international financial markets regard these countries as the indicators of the pan-EMU developments.

Without reducing the number of the Governing Council members the Executive Board's position could be strengthened by formal or informal rules (Vollmer, 1999, 308). For example, one can imagine that proposals of the Executive Board need a large majority to be rejected.

Sometimes, decreasing the size of the Governing Council is also proposed to avoid central bankers expressing divergent opinions to the public. The lack of "one voice" has been blamed for the external weakness of the Euro. But it is quite doubtful whether this aim can be attained in this way:

(1) Even small monetary committees fail to speak with one voice and do not give clear signals to the markets (Issing, 1999, 10 f., The Economist, 2000a).
(2) Some members even of the ECB's Executive Board think that a public discussion on mone-

tary aspects is no problem at all (Padoa-Schioppa, 2000).

(3) Even national central bankers without any responsibility for European monetary policy give statements e.g. on the ECB's interest rate decisions. So Klaus-Dieter Kühlbacher, the president of the Landeszentralbank (regional central bank) of Berlin and Brandenburg and in this capacity also member of the Bundesbank's central council, was quoted in the press on interest rates (Shirreff, 2000, 106). But the Bundesbank's Governor is absolutely independent relative to the Bundesbank's Council, when he casts his vote in the ECB Governing Council. The national central bankers in EMU must yet learn their new functions. This is a special aspect of the general problem dividing tasks and responsibilities between ECB and NCBs.

2.2. The Relationship between the ECB and the NCBs

The adoption of the monetary policy strategy, the choice of the instruments, and the setting of interest rates, in one short word: the monetary policy-making decisions, are the concern of the ECB. So, on the one hand, the Eurosystem is a one-tier system. On the other hand, it is a two-tier system, for the task of implementing the monetary policy is shared by the Executive Board and the NCBs. According to Article 12 of the Statute, the NCBs carry out monetary operations "[t]o the extent deemed possible and appropriate". The decentralized implementation of the common monetary policy might cause several problems.

With the exception of foreign-exchange interventions all monetary operations have to be settled through the NCBs (Bini Smaghi, Gros, 2000, 17 ff.). Commercial banks must hold their minimum reserves with the appropriate NCB and they get liquidity from it. The Eurosystem has to grant credits to commercial banks only against adequate collateral. There are two kinds of eligible collateral assets: EMU-wide standardized "tier-one assets" and "tier-two assets", which are used in some countries only and selected by the NCBs. Although tier-two assets as the German "Wechsel" (a trade bill) can be used in each EMU country, they are almost never used as cross-border collateral (Favero et al., 2000a, 14 f.). The use of those assets does not contribute to an integration of the Euro money market.

Some functions are performed in the ESCB by either the ECB or the NCBs or - as holding foreign reserve assets - by the ECB and the NCBs. Beside those monetary policy functions the NCBs may also perform other functions. These functions may interfere with the monetary policy and therefore affect the relationship between ECB and NCBs. Among these functions is the responsibility for banking supervision and financial stability. In acting as lender of last resort, actions of the NCBs affect the money supply in EMU. But a two-thirds majority in the Governing Council would be necessary to declare functions incompatible with the aims and tasks of the ESCB. It is uncertain whether a coordination of national supervision policies is sufficient to prevent an EMU-wide financial crisis. But only a decision, unanimously taken by the ECOFIN council, can give the ECB some authority in the field of banking supervision. The Treaty would have to be amended to give the ECB general responsibility for those tasks, which are now, at least in some countries, responsibilities of the NCBs. One can expect that those asymmetries will continue for a long time.

Another asymmetry between the ECB and the NCBs is the size of the staff with analytical and research functions. Most of the staff is employed by the NCBs. Some NCBs of the smaller countries even increased the number of their staff. Their staff is now responsible for providing statistical and research support to their respective governor. In the past there was not any need for sophisticated analytical work when those countries were targeting an exchange rate (Buiter, 1999, 22 f.). The Executive Board was able to increase its staff in the first two years, although some NCBs were reluctant to agree to the planned expansion (e.g. Stark, 1999). As staffing affects the budget of the ECB, the NCB governors have to approve the staffing proposals of the Executive Board, which has no voting right on budgetary matters (Smaghi, Gros, 2000, 7 f.). Not until January 2000, the important directorate for statistics was upgraded to a directorate-general and deficits still remain in the field of economic statistics on EMU level (ECB, 2000). This can be seen as a sign of NCB governors' preference for a bottom-up flow of analysed data. The existence of independent NCB statistical and research departments apart from respective ECB departments intensifies the competition among them and provides "useful safeguards against intellectual 'democratic centralism'" (Buiter, 1999, 26). It does not make centralized analysing of data superfluous.

3. Political Bodies in the Field of Monetary Policy

3.1. The Role of ECOFIN and other EC Councils

The ECB is the most important monetary policy body in EMU. It is granted high degrees of financial, institutional, personal and instrumental independence. This independence is of course not an absolute one, not only because the European central bankers are appointed by political institutions, but also because of the legislative power of the ECOFIN council concerning some monetary instruments. So the basis for minimum reserves, the maximum permissible ratios between minimum reserves and their basis and the kind of sanctions in the case of non-compliance had to be defined by the ECOFIN council, although on a recommendation from the ECB. The assent of the European Parliament was not required. Now the ECB can adopt minimum reserve policy within the framework designed by the ECOFIN council. The same procedure applies to the transfer of foreign reserve assets from the NCBs to the ECB. The limits within which these assets can be transferred are to be set by the ECOFIN council. In other cases, ECOFIN can amend the Statute, on a recommendation from the ECB or on a proposal from the Commission, only with the assent of the European Parliament. In all cases the decisions are taken by an institution of the EC, not by an EMU body. Does that mean that the "...EuroGroup ministers are not masters in their own house", as *The Economist* stated some weeks ago (The Economist, 2000b)? It is true that only ECOFIN (or more general: the Council) is a legislative body, even in cases regarding matters that are relevant only in the Euro area. But the voting rights of the outs are suspended for some council decisions concerning e.g. measures against member countries with excessive government deficits, exchange-rate arrangements and the appointment of the members of the Executive Board. The outs do have voting rights, when the council takes decisions on e.g. minimum reserves and the transfer of foreign reserve assets, although these decisions do not have any effect on the NCBs of the outs. They can participate in designing secondary law and the framework they have to observe after adopting the Euro in the foreseeable future. Taking part in the decision-making process is of essential importance when regulations are path-dependent. That means e.g., whether a monetary policy instrument is used or not in the future might depend on an accidental majority in the decision-making body in the initial period. Even if an enlarged EMU would have taken another decision, it is unlikely that such decisions will be revoked after those countries will have joined EMU. This outcome can be avoided by giving voting rights to the soon-members. This solution tends to respect the preferences of the future EMU in a better way than limiting the voting rights to present members.

As already mentioned, the outs do not have voting rights on all matters. Can a clear and reasonable distinction be identified between having voting rights and not having voting rights? On the one hand, it seems reasonable to exclude the outs from the appointment of the Executive Board members. Soon after four years, one member of this body will have to be replaced for the first time, and on that occasion then new members will be allowed to give their votes on the successor. So, the exclusion of present non-members in that case does not cause real difficulties. On the other hand outs do not vote on matters of the EC's exchange-rate policy, although they would be included in existing arrangements when joining EMU. In practice, this does not cause difficulties either, because a formal exchange-rate agreement for the Euro in relation to non-Community currencies is improbable. The ECOFIN council may alter general orientations for exchange-rate policy by a qualified majority. This provision gives new members a real chance to influence exchange-rate matters.

Whether it is rational or acceptable at all to give the outs legislative power on matters which do not apply to them at the moment, depends first on the duration of their special status. The voting right of states with a real temporary derogation ("pre-ins" in the true sense of the word) can be accepted for the reasons set out above. This argument does not apply to states which do not intend to join EMU or which will stay outside for a long time because they do not comply with the convergence criteria (Smits, 1997, 507). This could be the case for most of the states in Middle and Eastern Europe when they join the EU in a few years.

A second aspect is, whether unanimity or qualified majority is required in taking decisions. In the case of unanimity, an out having the right to vote would be able to hamper the ins, even if all of them want to take action. Unanimity is required e.g. when the ECOFIN council intends to confer specific tasks concerning banking supervision upon the ECB. It is not yet clear whether all ins want to do that, either because they prefer a separate authority or because they prefer national institutions. But it is quite clear that the UK does not want the ECB to be responsible for banking supervision, so this country (as an out) might hinder the ins to create new responsibilities for the ECB. Some economists consider this shift of competences necessary for a good functioning of European monetary policy. Here, the dividing line between topics on which the outs do or do not have the right to vote has not been drawn in an optimal manner.

Having voting rights suspended must be distinguished from not being represented in a decision-making body. Of course, all EU member states take part in ECOFIN and other councils. Even if their voting rights are suspended, outs have influence on the decision-making process by discussing, making proposals etc. Due to the log-rolling in the voting on several matters, their opinions are not irrelevant to those having the right to vote. So it makes a big difference whether the voting rights for some states are suspended or whether the states with voting rights form a decision-making body of their own.

3.2. Euro 11

Having in mind the outlined possible influence of the outs, even when not entitled to vote, the desire of the ins for a body of their own is understandable. During the Luxembourg summit in December 1997, a resolution was passed, admitting the finance ministers of the ins to meet informally, the ECOFIN council remaining the decision-making body. So we have quite different situations on the side of central banks and on the side of politics: In the ESCB, the central banks of the countries not adopting the common single currency are excluded from the primary decision-making body; they have a seat (and a vote) only in the ECB's General Council. Its role is in the first place an advisory one. It can take decisions only on matters of minor importance. On the side of politics, the ins and outs constitute the decision-making body; the caucus of the ins, called "Euro 11", is only a discussion forum. Of course, this discussion may lead to a common position and a bloc-voting of all ins in the ECOFIN council. An agreement of the ins to vote en bloc in the ECOFIN council would ensure the qualified majority of Euro 11. Even if Euro 11 applied the two-thirds majority principle, free voting casts in the ECOFIN council could miss this majority by a wide margin.

Especially France, but also some other states wanted to enhance the role of Euro 11 from the very beginning of EMU. According to the first French plans, Euro 11 should serve as a European "economic government" and act as a political counterweight to the ECB. Because of the negative reaction of the markets, fearing that the independence of the ECB could be reduced, most countries abandoned this idea (The Economist, 2000b). A few weeks ago France, presiding at the ECOFIN council in the second half of this year, made every effort to revive some parts of its original plan. Euro 11 is now called "Euro Group"[6)], its meetings now do not begin just a few hours before the ECOFIN council starts but on the evening before, and its chairperson gives

[6] Not to be confused with the "private" Euro Group, consisting of former central bankers and former high-ranked politicians as well as present members of the European financial community (Frankfurter Allgemeine Zeitung, 2000). The term "Euro 11" would not be correct any longer, for now also the Greek minister attends the meetings even before the admission of Greece to EMU in January 2001.

more political statements (The Economist, 2000e).

This formal strengthening of the Euro Group was facilitated by the fact that the weakening of the Euro was accompanied by divergent political statements (OECD, 2000, 61 f., The Economist, 2000d). Many politicians as well as many economists saw the need for "one voice" on exchange-rate matters in EMU. Due to the relative strong Pound Sterling and the relative strong Swedish krona, the ECOFIN council, representing the Euro as well as those currencies, could not be expected to deliver a clear-cut manifestation on exchange rates to the markets. So, the first statement of the Euro Group was on exchange-rate matters, but it did not impress the financial markets (The Economist, 2000b).

In general, as far as there are common interests between the ins, but divergent interests between ins and outs, declarations of Euro 11 might be more credible than those of ECOFIN. Thus, a closer cooperation between the ins might be beneficial for Eurozone. But some countries intend to change the division of responsibilities between politics and ESCB. The strengthening of the Euro Group might be a step to achieve this aim.

4. The Assignment of Tasks

4.1. Setting the Inflation Target

Compared with other central banks, the ECB has a great degree of goal independence. The Treaty and the Statute state only that its objective is to maintain price stability. This goal is not quantified, neither in the Treaty nor in the Statute. It is to the ECB's Governing Council to put this goal in a numerical target. The ECB has done so in defining price stability as a rise of the harmonised index of consumer prices below 2 per cent per year. The stability-oriented monetary policy strategy of the ECB is based on two pillars, a preannounced reference value for the growth of the monetary aggregate M3 and a broadly defined assessment of monetary developments with regard to price stability.

There might be situations in which one pillar gives signals for expanding money supply, while the other gives contrary signals. So, the ECB has to explain monetary policy decisions more in detail than in the case of one target. The communication of the ECB regarding its two-pillar strategy did not always succeed. This has to be kept in mind when we look at some proposals concerning a reduction of the ECB's goal independence.

Especially the French minister of finance, but also some economists, would like to give the competence of fixing the inflation target to a politically accountable institution. Some, as the French minister Fabius, prefer Euro 11, while other prefer the ECOFIN council or - after a reform - the European Parliament (Favero et al., 2000a, 70 f.). The ECB's monetary policy would then become a mere technical matter, similar to some other countries where the target inflation rate is set by the government. Proponents of this sharing of tasks argue, that "[s]uch reform would contribute to fewer national tensions in policy-making" (Favero et al., 2000a, 70). But the contrary might be true, and in all probability the priority of price stability would be reduced in certain economic circumstances. There is no reason why a goal-independent ECOFIN council should perform better than a goal-independent ECB.

4.2. The Responsibility for Exchange-Rate Policy

Without reducing the formal independence of the ECB, its actual independence could be reduced by exchange-rate arrangements. Therefore the Treaty states that such arrangements or orientations for exchange-rate policy have to be consistent with the objective of price stability. Whereas the provisions of the Treaty with regard to formal arrangements are clear, those concerning general orientations are less clear (Favero et al., 2000b, 7). They give finance ministers the opportunity to talk about appropriate exchange rates and even to propose exchange-rate target zones (Buiter, 1999, 9). The ECOFIN council has not given any general orientations yet. In a report to the European Council in December 1997, the ministers announced that they will give such orientations in exceptional circumstances only (ECB, 1999a, 41). However, nobody knows when these circumstances are considered to have set in and whether the ECB is entitled to suspend interventions when price stability is in danger. A legally binding, clear self-restraint of the ECOFIN council could give an unambiguous signal to the markets, ensuring the independence of the ECB as in the ERM II. According to this formal agreement, the ECB and the NCBs have the right to initiate a procedure to realign the central rates (Issing, 2000, 147).

5. Conclusions

The institutional framework for monetary policy in EMU fulfils the prerequisites which are necessary to secure the independence of the ECB and the NCBs and to give price stability unambiguous priority. But the framework does not automatically guarantee this independence and price stability. There are some potential loopholes to undermine a stability-oriented monetary policy. Institutional reforms could remove these loopholes and could make monetary policy more efficient. But also the contrary might occur as a result of institutional reforms: a less clear assignment of tasks, less political independence of the ECB, a less stability-oriented monetary policy. The differences between the member states concerning goals and institutions of EMU which could be observed in the late eighties and the early nineties might reappear. Deep monetary integration in the European Union was made possible by the special economic and political circumstances prevailing in the early nineties which contributed to suppress those differences (Swann, 1995, 236).

The institutional framework for monetary policy in the EU will change in the future as did the framework for other common policies in the past. The structure of national central banks, which were highly decentralized in their beginnings, changed over time. So, in the first years of the Deutsche Mark, the German central bank system was even more decentralized than the Eurosystem is today.[7)] The Bundesbank was built up in 1957, nine years after the introduction of the

[7] The Bundesbank is often referred to as the model for the ECB. But its predecessor, the Bank deutscher

new German currency. It took until the German reunification to give up the system with a regional Main Office, known as land central bank, in each Bundesland (German state), the respective president of which is member of the Bundesbank's central council. It took even more time to reduce the size of the council.

Finally, an enlargement of the EU will make some changes in the institutional framework necessary. Perhaps the ongoing economic and political integration will make such reforms easier. One can imagine that the European Parliament will gain influence on the appointment of the members of the ECB's Governing Council. One can also imagine that an independent financial market supervision authority will be established, which in the beginning will have the task of facilitating information exchange and coordinating measures. An independent European Council of Economic Advisers, as proposed by Siebert (2000, 17), could act as an audience for the ECB to explain its policy. Such a council would far less be suspected of trying to undermine the independence of the ECB than e.g. the Euro Group.

At the moment, the institutional framework for monetary policy is certainly not ideal, but it is suitable for a good performance. EMU is still under construction, and the future will show whether some parts of the monetary architecture are stable or not. In the past, the EU did not always prove to be able to react to a changing economic environment, which makes changes in the institutional framework necessary. International financial markets will urge a change of inappropriate institutions, so the EU should be prepared. But this does not mean that proposals on institutional change should be launched every week. A new currency needs a stable framework, even if it is only a second-best framework. Albeit not optimal, the present framework for European monetary policy is workable.

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Laender (BdL), seems more fitting in some respects. The constituents of the BdL were the legally independent regional central banks of the states of the Federal Republic of Germany. Their governors were appointed by the respective state government and formed with the president of the Governing Council and the president of the Executive Board the Governing Council of the BdL. The regional central banks were even more independent than the NCBs in the ESCB. The fixings and changings of interest rates, which were decided in the Governing Council, did not come into force automatically in West-Berlin, but had to be approved by the Berlin central bank for its district. Of course, in a unified market, differences in interest rates could not exist for a long time, so generally the same rates were adopted by all regional central banks (Jochimsen, 1999, 49 f.). A formal aspect may also show their position: the president of the Governing Council was not at the same time president of the Executive Board; both were elected by the governors of the regional central banks.

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