

Herz, Bernhard; Nürk, Bettina

**Article**

## No significant impetus to greater economic policy co-ordination

Intereconomics

Suggested Citation: Herz, Bernhard; Nürk, Bettina (1990) : No significant impetus to greater economic policy co-ordination, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 25, Iss. 4, pp. 179-184, <http://dx.doi.org/10.1007/BF02926168>

This Version is available at:

<http://hdl.handle.net/10419/140250>

**Standard-Nutzungsbedingungen:**

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

**Terms of use:**

*Documents in EconStor may be saved and copied for your personal and scholarly purposes.*

*You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.*

*If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.*

Bernhard Herz, Bettina Nürk\*

## No Significant Impetus to Greater Economic Policy Co-ordination

The first stage of European Economic and Monetary Union (EMU) began on 1st July 1990, amidst high expectations. The process of European integration will now involve economic policy more than it has in the past. It is widely held that the danger of regional imbalances and exchange rate strains increases in an integrated economic and financial area in which member countries pursue differing economic policies. "A more effective co-ordination of economic policy between separate national authorities" and "Community policies in support of a broadly balanced development" are therefore regarded as an indispensable complement to the single market.<sup>1</sup>

The first stage of EMU, which is seen as a "training phase" for stages two and three, provides for an intensification of economic policy co-ordination between EC member countries at the operational level. At the same time, the institutional framework is to be created for a single European economic and monetary area, and in particular for a European System of Central Banks; an intergovernmental conference will be convened for that purpose in December 1990.

If member governments and central banks succeed in increasingly co-ordinating their policies, they could in effect achieve EMU even before the institutional details have been worked out and the necessary laws ratified by national parliaments. Conversely, a lack of progress towards greater economic policy convergence during the first stage could adversely affect the negotiations on the amendment of the EEC Treaty. The member states that view monetary stability as primary objective will be influenced in their actions not only by the declarations of intent and legislative proposals of fellow governments but also and above all by the policies they actually pursue. Only if there is a high degree of convergence in practical policy as well as at the level of rhetoric will these countries be prepared to surrender economic decision-making powers to the Community. The success or failure of the first stage will therefore be

important in determining the shape of integration in the future, as the negative experience of earlier attempts at creating a single European economic and monetary area have made abundantly plain.

In their report, the Delors group noted that some progress had been made in the co-ordination of monetary and fiscal policies but that much remained to be done in this respect and suggested amending two earlier Decisions of the Council of Ministers on policy co-ordination. Accordingly, the Council approved the following two Decisions in March 1990:

□ the "Council Decision of 12 March 1990 amending Council Decision 64/300/EEC on co-operation between the central banks of the Member States of the European Economic Community",<sup>2</sup> which widens the tasks and role of the Committee of Central Bank Governors, and

□ the "Council Decision of 12 March 1990 on the attainment of progressive convergence of economic policies and performance during stage one of economic and monetary union",<sup>3</sup> in which the Council appointed the Council of Economic and Finance Ministers (Ecofin) to carry out half-yearly multilateral surveillance of economic developments and policies in the EC.<sup>4</sup>

The purpose of these decisions is to put economic policy co-ordination on a new footing during the first stage of EMU. This article will therefore examine

□ what innovations the new Decisions bring by comparison with the old arrangements for economic policy co-ordination in the EC, and

□ whether, in the light of previous experience with policy co-ordination within the Community, these

<sup>1</sup> Cf. Committee for the study of Economic and Monetary Union: Report on economic and monetary union in the European Community (the Delors Report), Luxembourg 1989, p. 14.

<sup>2</sup> Official Journal of the European Communities, L78, Vol. 33, 24 March 1990, pp. 25-26.

<sup>3</sup> Official Journal of the European Communities, L78, Vol. 33, 24 March 1990, pp. 23-24.

<sup>4</sup> This procedure was first used on a trial basis in the summer of 1989.

\* University of Tübingen, West Germany.

Decisions provide an appropriate basis for greater economic policy convergence during the first stage of Economic and Monetary Union.

### Policy Co-ordination

The first stage that has just begun is the third attempt at European economic and monetary union. The Werner Report of 1970 and the creation of the European Monetary System in 1979 had already generated considerable impetus in this direction.<sup>5</sup> The Werner Report had emphasised the need for swift and lasting economic policy convergence if the objective of European monetary and economic union was to be achieved. As with the present plan, economic and monetary union was to be implemented in three stages to be completed by 1980. The strategy that was adopted could be described as "institutional" in character: new harmonisation bodies were created, such as the co-ordinating group and the Economic Policy Committee, and co-ordination was governed by formalised harmonisation procedures, such as those for the setting of economic policy guidelines. Co-ordination was perceived in broad terms and was to embrace all important areas of economic policy.

In the event, the newly created harmonisation procedures remained ineffectual. The Study Group "Economic and Monetary Union in 1980" chaired by Robert Marjolin, a former Vice-President of the Commission, therefore reached a damning conclusion in the spring of 1975: "Without denying some headway of a technical nature, notably as regards co-operation between the Central Banks, the Group considers that the efforts undertaken since 1969 add up to failure. Europe is no nearer to economic and monetary union than it was five years ago; in fact if there has been any movement it has been backward."<sup>6</sup> The main reason given for this, apart from the adverse economic climate due to the collapse of the Bretton Woods system and the 1973 oil crisis, was the lack of political will to surrender national sovereign rights and room for political manoeuvre.<sup>7</sup>

After the disappointing experiences with the ambitious concept set out in the Werner Report, it was logical that far more modest objectives should be pursued when the European Monetary System was introduced some ten years later. The EMS was designed to facilitate the convergence of economic development and give fresh impetus to the process of European Union, but no concrete timetable was laid down for EMU.<sup>8</sup> The policy co-ordination strategy is also different, since co-ordination is confined to the monetary field.

National monetary policies are co-ordinated implicitly via a system of fixed exchange rates, rather than by means of explicit formal harmonisation procedures and bodies.

Today this procedure is generally considered to have been at least a partial success. Exchange rate fluctuations among the participating currencies have been reduced and inflation rates have converged towards a relatively low level. At the same time, however, increasing imbalances are evident in trade between EMS countries, and national fiscal policies continue to differ significantly. Despite the successes of the EMS, it has not been consolidated into a "final system", as was originally planned; according to the Resolution of the European Council of 5th December 1978, this second institutional stage should have begun not later than two years after the inauguration of the scheme. These experiences provide some basis for assessing the new decisions with which the European Council prepared for the further attempt at an Economic and Monetary Union after another ten years of cyclical economic management.

### The New Decisions

The new decisions on policy co-ordination within the EC are to be seen against the background of two fundamental trends:

- in the field of fiscal policy, member countries are attempting to supplement the existing informal co-ordination procedure by a system of universally binding fiscal policy guidelines while in principle upholding national autonomy. This is occurring against the background of a move in all member countries away from general demand management towards stabilisation policies geared more towards the supply side;
- in the area of monetary policy, on the other hand, the aim is to change from the previous practice of implicit policy co-ordination within the framework of the EMS to an explicit co-ordination procedure by transferring responsibility for monetary policy to the Community level within a European System of Central Banks.

---

<sup>5</sup> The first steps to bring about monetary union were taken after the conclusion of the first stage in the transition to the Common Market on 31 December 1961. Both the Commission in its action programme for the second stage and the Monetary Committee in its fourth Annual Report described the introduction of close monetary policy co-ordination as necessary in view of the progress towards economic integration.

<sup>6</sup> Bulletin of the European Communities, No. 4/1975, p. 29.

<sup>7</sup> Ibid.

<sup>8</sup> See for example the Conclusions of the Presidency of the European Council in Brussels in December 1978, in: Bulletin of the European Communities, No. 12/1978, pp. 9f.

In the remarks that follow, the consequences of the introduction of the first stage of EMU for economic policy co-ordination within the European Community will be examined separately as regards the monetary and fiscal spheres.

The preamble to the 1974 Council Decision on economic convergence emphasised that there could be no gradual attainment of economic and monetary union (by 1980) "unless the economic policies pursued by the Member States henceforth converge and unless a high degree of convergence is maintained".<sup>9</sup> Concrete objectives were not laid down, however. National economic policymakers therefore had wide latitude to decide which economic variables should converge and the level at which this should happen. The co-ordination process therefore entailed not only deciding appropriate policy measures but also repeatedly laying down the final policy objectives, which were constantly changing. Further conflicts were therefore bound to occur.

The new Decision on convergence, by contrast, sets out the desired objectives: the magic triangle of "sustained, non-inflationary growth in the Community together with a high level of employment".<sup>10</sup> In undertaking surveillance, the Council is also required to apply the principles of "price stability, sound public finances and monetary conditions, sound overall balances of payments and open, competitive markets".<sup>11</sup> The aims are therefore explicitly laid down, but without indicating an order of precedence in the event of a conflict between different objectives. The fundamental problem is therefore the same as before; all that has changed is that the debate is no longer about the objectives to be pursued but about their relative importance.

### **Decentralisation of Fiscal Policy Co-ordination**

The old co-ordination procedure was based on the Community's normal procedural rules. The Commission made proposals for economic policy guidelines and for the Annual Economic Report, which the Council discussed and adopted after consulting the European Parliament and the Economic and Social Committee. This original concept of co-ordination on the basis of economic policy guidelines laid down centrally by the Commission is now discredited, mainly because of the strong centralisation and "politicisation" of the co-ordination process.

The new concept is far less ambitious and is based more strongly on current economic policy practice. In the final analysis, member countries are merely given a forum in which the international effects of national

measures can be discussed. In order to promote compatibility between national policies, "the Council may make economic policy suggestions and, upon a proposal of the Commission, issue economic policy recommendations".<sup>12</sup>

In effect, powers have therefore been transferred back to the national level. The Council of Ministers rather than the Commission now has the right of initiative and plays the central role in economic policy co-ordination. The new arrangement therefore takes account of the fact that member states are not yet prepared to surrender their autonomy in matters of fiscal policy.

Under the new Decision on convergence, the previous, formally very differentiated policy procedure is replaced by the more open multilateral surveillance. The co-ordination procedure laid down in the 1974 Decision had provided for the Council of Ministers to discuss economic and monetary matters once a month. In a multi-stage procedure, *ex ante* economic policy guidelines for member states were adopted, adjusted in the course of the year and then evaluated *ex post* in the subsequent Annual Economic Report. If economic "disturbances" occurred, different procedures were to be followed, depending whether it was a case of national measures that departed from the Council's guidelines, serious reservations about policies contemplated by member states or economic developments in one member state that posed a considerable danger to other member countries.

Multilateral surveillance takes the completely opposite path; the formalised procedure, where the participating government representatives were concerned about publicity, is replaced by very informal and discrete monitoring. Past experience has shown that the old procedure was too "politicised" because of its public orientation. Objective discussion of the economic problems of individual countries was not possible and no binding commitments were made with regard to policy measures. The Council of Ministers therefore carries out multilateral surveillance in restricted sessions, with only the finance ministers and their deputies present. The significance of an informal

---

<sup>9</sup> Council Decision of 18 February 1974 on the attainment of a high degree of convergence of the economic policies of the Member States of the European Economic Community, in: Official Journal of the European Communities, L63, 5 March 1974, pp. 16 ff.

<sup>10</sup> Council Decision of 12 March 1990 on the attainment of progressive convergence of economic policies and performance during stage one of economic and monetary union, op. cit., Article 1.

<sup>11</sup> Loc. cit.

<sup>12</sup> Ibid., Article 2.

exchange of views is also evident in the growing importance of the half-yearly unofficial meetings between finance ministers and central bank governors, which are held outside the institutional framework of the EC.

When potential or actual economic developments in one or more member states threaten the economic stability and cohesion of the Community, the initiative for examining the economic situation lies solely with the Council, which may make recommendations as to necessary economic policy corrections.<sup>13</sup> If a threat of this kind stems from events outside the Community, "consultation shall take place in the appropriate Community bodies to consider possible measures".<sup>14</sup>

Multilateral surveillance by the Council of Ministers is prepared by the Monetary Committee, whose influence is therefore increased.<sup>15</sup> The Economic Policy Committee, on the other hand, is involved only indirectly in the co-ordination process.<sup>16</sup> In future, the membership of the Monetary Committee at the meetings that prepare the Council's work on multilateral surveillance will include, as experts, a representative of each member country and of the Commission from among the members of the Economic Policy Committee. This indirect involvement of the Economic Policy Committee in multilateral surveillance came about as a result of pressure from the German Government and is to be seen against the background of interministerial rivalry; the move was designed to prevent the Ministry for Economic Affairs, which is represented in the Economic Policy Committee, from losing any further influence in matters of European policy co-ordination to the Ministry of Finance, which is represented in the Monetary Committee. This arrangement is counterproductive from the point of view of policy co-ordination, since it again increases the number of participants and thus reduces the efficiency of the Monetary Committee. The specific advantage of this body lies in the fact that a small, experienced circle of high-ranking experts can discuss problems of policy co-ordination in a confidential atmosphere.

The co-operation between the co-ordination bodies is improved by the attendance of the committee chairmen at the meetings of other bodies. For example, the chairmen of the Economic Policy Committee and the Monetary Committee will in future attend the Council meetings at which multilateral surveillance is carried out. To promote consistency between monetary and other economic policies, the Chairman of the Committee of Governors of the Central Banks will also be invited to the relevant meetings of the Council.

The European Parliament continues to be excluded from direct involvement in policy co-ordination, although it has been given greater rights to be informed by the Council, the Commission and the Committee of Governors. The only concession it was able to gain was the right to invite the President of the Council "to appear before the competent Committee of the European Parliament when the Council has issued policy recommendations".<sup>17</sup>

The 1964 and 1974 Decisions on co-ordination had already attempted to harmonise national economic policies *ex ante* at the planning stage. The new Decision on convergence also aims in this direction and requires the Council to review budgetary proposals "possibly" in advance of national budgetary planning.<sup>18</sup> However, there is no provision for mechanisms and sanctions that could force the co-ordination of budgetary planning. The new Decision on convergence speaks only of "learning by doing", which should increasingly lead to compatible

<sup>13</sup> Cf. *ibid.*, Article 5.

<sup>14</sup> *Ibid.*, Article 6.

<sup>15</sup> Each EC country is represented in the Monetary Committee by one member from the Ministry of Finance, usually an undersecretary of state, and one member from the central bank. Two experts from the Commission also take part.

<sup>16</sup> The individual member states and the Commission are each represented on this Committee by four lower-ranking officials.

<sup>17</sup> Cf. Council Decision of 12 March 1990 on the attainment of progressive convergence of economic policies and performance during stage one of economic and monetary union, *op. cit.*, Article 8.

<sup>18</sup> Cf. *ibid.*, Article 3.

PUBLICATIONS OF THE HWWA-INSTITUT FÜR WIRTSCHAFTSFORSCHUNG-HAMBURG

## WELTKONJUNKTURDIENST

Annual subscription rate  
DM 80,-  
ISBN 0342-6335

This quarterly report – compiled by the Department of World Business Trends of the Hamburg Institute for Economic Research (HWWA) – analyses and forecasts the economic development of the most important Western industrial nations and of the international raw materials markets.

VERLAG WELTARCHIV GMBH - HAMBURG

economic policies with precise and appropriate commitments by the member states.<sup>19</sup>

In the light of experience so far, the first stage of Economic and Monetary Union cannot be expected to generate new impetus for a more binding harmonisation of fiscal policies; it will therefore bring no changes of substance. The new Decision on convergence aims instead to codify economic policy practice as it has evolved in recent years.

### **Change in the Emphasis of Economic Policy Objectives**

The revised Council Decision on co-operation between the central banks of the EC reflects the further development of monetary policy co-operation within the EMS and should be seen against the background of efforts to establish a European System of Central Banks. Closer co-ordination of national policies should prove easier in the monetary domain than in the fiscal field, since a very stringent implicit co-ordination procedure already exists in the form of the exchange rate mechanism of the EMS. During the "learning phase" of EMU this harmonisation mechanism is to be developed into an explicit co-ordination procedure.

The sole objective mentioned in the 1964 Decision concerning the Committee of central bank Governors was exchange rate stability. When the EMS was set up, this objective was reinforced by the reference to monetary stability as a fundamental element in the strategy for achieving faster economic growth with stability, full employment and harmonisation of living standards in the EC.

In the new Decision on co-operation between the EC central banks, economic and social cohesion within the Community and non-inflationary growth are again cited as ultimate objectives, but in contrast to the earlier decisions internal price stability is now described as a precondition for stable exchange rates and essential for the success of Economic and Monetary Union. Accordingly, monetary policies within EMU are to be orientated towards price stability.

The new Decision on co-operation among EC central banks gives the Committee of Governors new rights and duties. Its role as the nucleus for a future European System of Central Banks is reinforced. The Committee must now be consulted before national authorities take decisions on the course of monetary policy, i.e. when setting credit and money supply targets. It may also express opinions to individual governments and to the Council of Ministers if they take measures that could affect the internal or external monetary situation in the Community. It prepares an annual report on its activities

and the monetary and financial conditions in the Community, similar to the annual reports of the national central banks, for submission to the European Parliament, the Council and the European Council. In addition, a small permanent staff to carry out monetary analysis is being formed at the seat of the Committee of Governors at the Bank of International Settlements in Basle. The position of the Committee of Governors is therefore being strengthened with the object of transferring monetary sovereignty to the Community and centralising monetary policy. In contrast to developments in the fiscal policy sphere, this entails a greater formalisation of monetary policy co-ordination.

It remains to be seen how much the influence of the Committee of Governors will increase. The new Decision on central bank co-operation creates the necessary legal basis, but many avenues for avoiding the intended tighter co-ordination will remain open to national decisionmakers. One example lies in the cautiously formulated attempt to achieve greater *ex ante* co-ordination of monetary policy; in accordance with the new Decision, the Committee shall "normally be consulted before the national authorities take decisions on the course of monetary policy, such as the setting of annual money supply and credit targets".<sup>20</sup> What is meant by "normally" is not further explained. Hence in monetary policy too it is left to member states to decide whether to co-ordinate their planning.

In addition, the influence of the Committee of Governors is severely restricted on many fronts during the first stage of EMU. As already mentioned, monetary policy co-ordination takes place *de facto* via the EMS, so that national monetary policies need not be harmonised in discussions within the Committee of Governors but are co-ordinated in the framework of exchange market intervention or via national measures to avoid such intervention.

Moreover, the majority of members of the Committee of Governors are not politically independent but are bound by instructions from their finance ministers. Interestingly, at present there is no forum within the EC in which those responsible for national monetary policy meet directly at the highest level. The majority of central bank governors belonging to the Committee of Governors are not independent, and conversely the Deutsche Bundesbank, as an independent central bank, is not represented in the Council of Ministers. It is only in the Monetary Committee that all the monetary

<sup>19</sup> Cf. *ibid.*, Article 2.

<sup>20</sup> Council Decision of 12 March 1990 amending Council Decision 64/300/EEC on co-operation between the central banks of the Member States of the European Economic Community, *op. cit.*, Article 3.

policymakers are present, if "only" at the level of alternates.

Furthermore, the individual representatives of member states can face problems as a result of their dual role as a member of their central bank and as a member of the Committee of Governors. Situations could conceivably arise in which, say, the President of the Deutsche Bundesbank faced a conflict of duties and responsibilities, for while acting as a member of the Committee of Governors he must pursue the objectives of the Community, but as a member of the Central Bank Council he is obliged to perform the duties set out in Article 3 of the Law on the Deutsche Bundesbank.

Finally, it remains to be seen what consequences will flow from the appointment of the President of the Deutsche Bundesbank as Chairman of the Committee of Governors of Central Banks for a period of office that has now been extended to three years. On the one hand this could be seen as an indication of the readiness of the other member states to align themselves explicitly with the Bundesbank's objectives in the context of monetary policy co-ordination and to give price stability priority over all other target variables. Conversely, it is also conceivable that this is a way of committing the German central bank Governor to targets set collectively, so that the soft currency countries can regain greater influence over monetary policy in the Community.

### Prospects

In the light of developments so far, it is unlikely that fiscal policy co-ordination will be significantly intensified in the first stage of EMU.<sup>21</sup> In the final analysis, the new Decision on convergence does not establish a new co-ordination mechanism but codifies the economic policy practice that has proved feasible over the years; the EC institutions provide fora within which economic developments and policy measures can be discussed. Co-ordination therefore remains much less stringent in fiscal policy than in monetary policy. Experience has shown that European governments and parliaments are very reluctant to surrender even part of their fiscal autonomy. At best, agreement on a series of fiscal policy principles, such as abstention from the monetisation of the public debt or rules for assessing debt ceilings, appears to be feasible in the second and third stages; fleshing out and applying co-ordinated budget rules of this kind would still be the responsibility of national governments and administrations.

In monetary policy, on the other hand, governments and parliaments will probably raise less opposition to transferring sovereign rights to a supranational institution in the next two stages of EMU. In this area

they have already surrendered their autonomy to the Deutsche Bundesbank in any case, either explicitly by law, as in the Federal Republic of Germany, or implicitly, as in the other EMS countries, through participation in the exchange rate mechanism. During the transitional first stage, however, no intensification of direct *ex ante* co-ordination of national monetary policies in the Committee of Governors is to be expected.

As long as Community institutions have no power to ensure that agreements are implemented, the efficient harmonisation of stabilising policy among the member countries is not possible: "No matter how well thought-out they are and however many areas relevant to stabilising policy they cover, co-ordination bodies are useless as long as divergent economic policies are pursued and there is no threat of sanctions";<sup>22</sup> not only is there no coercion forcing national governments to abide by the common guidelines but there is also little incentive to do so, for no country can be certain that the other members will implement the measures they have promised, so that each country will be all the more cautious about abiding by its own commitments. There is also the danger that countries will make far-reaching promises they have no intention of keeping in order to induce other member states to make further concessions.

Against this background, the first stage of EMU cannot be expected to give significant impetus to greater economic policy co-ordination in Europe. The innovations that have been introduced do facilitate the discussion of economic policy, but they continue to rely essentially on the old procedures for co-ordination, or rather non-co-ordination. It is therefore up to the intergovernmental conference in December 1990 to initiate EMU by making institutional changes. The preparatory negotiations are showing, however, that some countries still have very deep reservations about surrendering sovereign rights. However, the current moves towards EMU are not likely to suffer the fate of the two previous attempts. In view of the progressive integration of the produce and financial markets, member countries are becoming increasingly aware of the inefficiency of independent economic management, so that they are becoming more willing to undertake greater policy co-ordination. However, to hope for more in the immediate future would be unrealistic and would inevitably lead to disappointment.

<sup>21</sup> See also N. Klöten: Der "Delors-Bericht", in: Europa-Archiv, Vol. 45, 1989, pp. 251-260.

<sup>22</sup> Alfred Müller-Armack, Rolf Hasse, Volker Merx and Joachim Starbatty: Stabilität in Europa. Strategien und Institutionen für eine europäische Stabilitätsgemeinschaft, Düsseldorf and Vienna 1971, pp. 74f.