



## FOR A STABLE SINGLE CURRENCY

### The Bundesbank in the history of European monetary integration

*The basis of European monetary union (EMU) is a treaty concluded by the governments – not the central banks – of the participating countries. The Bundesbank did play a significant part in the creation of EMU, however. It played a crucial role in the process of integration ultimately moving in the direction of a monetary union geared to the objective of price stability. Nevertheless, it did not press ahead resolutely in launching the monetary union. This was because the Bundesbank was not concerned with the pace of integration but with taking the right course of action.*

In 1992, when the governments of the EU took a decision, in Maastricht, on the establishment of European monetary union, they gave it an institutional framework that was adopted from the statute of the Deutsche Bundesbank: a central banking system with a decentralised structure which is independent of political instructions and is primarily committed to the objective of price stability. To that extent – as well as in the monetary policy strategy and instruments – the “legacy” of the Bundesbank is a constant and vital presence in today’s Eurosystem.

### The “Bundesbank principle”

How did it come about that the “Bundesbank principle” was accepted for the monetary union? First of all, this was due to the convincing success of this principle, which was able to inspire confidence in the new single currency. The D-Mark was one of the most stable currencies in the world. With its orientation to the objective of price stability and its independence, the Bundesbank made a crucial contribution to this; whenever price stability had been at risk, it paid markedly less attention to the short-term stabilisation of economic activity and employment than did the politically dependent central banks of many of its partner countries. Another important factor in the acceptance of the “Bundesbank principle” was that, for several decades, the Bundesbank had been patiently bringing its influence to bear on the course of European monetary integration – as a guiding, rather than a driving force. Not all of the Bundesbank’s original ideas were accepted and implemented, however, and sometimes it was criticised as holding back the process.

### Different ideas about integration

The initiatives for European monetary integration since the late 1960s were prompted, on the French side, by the presidents Georges Pompidou, Valéry Giscard d’Estaing and François Mitterrand, and, on the German side, by the federal chancellors Willy Brandt, Helmut Schmidt and Helmut Kohl (as well as the foreign minister, Hans-Dietrich Genscher). Compared with Germany, France suffered from a weak currency up to the end of the 1980s. Basically, France was aiming only for a European reserve fund, the intended aim of which was to stabilise the exchange rates between the European currencies at an average value and to minimise exchange rate fluctuations against the US dollar. For a long time, price stability was of secondary importance. The transfer of monetary policy powers to a single European institution was accepted – by necessity – only in the final phase of integration. German foreign policymakers were prepared to go a comparatively long way in meeting French aims. They wanted to involve Germany more strongly in Europe and, at the same time, promote the acceptance of their Ostpolitik (and, ultimately, reunification policy). Unlike in France, the German ministries of economics and finance as well as the Bundesbank were able to conceive of a monetary union only with a matching institutional design and not without national economic policies’ prior orientation to stability and not without the stable framework of a political union covering the other policy areas, and a system of fixed exchange rates only if it did not jeopardise price stability in Germany, ie only with limited intervention commitments in support of weak currencies.



# Ten years

United towards stable money

## The Werner Plan of 1970 – an early failed attempt

German economic, financial and monetary policymakers brought their basic positions to bear on the political initiatives, thus preventing European monetary integration taking a relatively inflationary course and the D-Mark becoming exposed to a major risk of inflation. The first large-scale attempt at a monetary union in the form of the 1970 Werner Plan failed because, owing to German influence – the Federal Ministry of Economics had acted in consultation with the Bundesbank – it contained conditions (parallel economic, institutional and political development) which were unacceptable for France. And the European Exchange Rate Arrangement set up in 1972 (later known as the “snake in the tunnel”), which was the concrete outcome of the Werner Plan with regard to integration, soon fell apart; the more inflationary currencies, such as the French franc, were unable to maintain their fixed exchange rate against the D-Mark.

## The ERM of 1979 – the integrating effect of the D-Mark anchor

In the second major attempt at monetary policy integration during the past few decades, the Exchange Rate Mechanism (ERM) of the European Monetary System (EMS) established in 1979, the Bundesbank played a multiple role which virtually prepared the way for the later monetary union.

- | On the Bundesbank’s insistence, the ERM was given a more stability-oriented constitution. Its initiators, Valéry Giscard d’Estaing and Helmut Schmidt, wanted to equip the ERM – in contrast to the “snake” – with an intervention mechanism which would allow the weaker currencies, including the franc, to maintain fixed exchange rates even without the monetary policy discipline of the price-stable currencies. In a setting of depreciating currencies, a stability-oriented Bundesbank would then have been required to buy unlimited amounts of the other participating countries’ currencies – this would have accelerated monetary growth and, therefore, the potential for inflation in Germany. The Bundesbank protested against this strategy. It was finally agreed that both the weak and the strong-currency central banks had to intervene if one currency reached the limit of the fluctuation margin against another currency. As in the “snake”, the strongest currency – not an average currency with higher inflation rates – was still the reference point for interventions; the commitment to grant currency support loans was extended but remained limited.
- | This comprehensive intervention obligation, combined with the Bundesbank’s ongoing stabilisation policy applied in the countries taking part in the ERM, set in train more restrictive economic and monetary policies, initially in France in 1982-83. For the countries with weaker currencies, there was no other way to avoid depreciations, which would damage prestige, and/or the loss of their monetary reserves. The D-Mark’s role as an “anchor” led to a fall in interest rates and a less frequent resetting of exchange rates. Such success in stabilising the European currencies was by no means complete – as was shown by the crises in the ERM in 1992-93; confidence in a new commitment to stability was built up only slowly. However, this was a necessary condition for the later establishment of monetary union.
- | At the same time, the ERM intervention mechanism and the Bundesbank’s stability policy encouraged countries with weaker currencies in their desire to escape the de facto management of their monetary policies by the Bundesbank, say, by creating a joint management body. France, for example, was able to overcome the entrenched lack of confidence in its monetary policy – and hold the exchange rate of the franc against the D-Mark – only if French interest rates were well above those in Germany. The high interest rates, however, placed a strain on growth, economic activity and employment. Finally, in 1988, France pressed vehemently for economic and monetary policy objectives to be placed in the hands of all the countries involved and not to left to a single country, Germany. In the end, Germany presented a proposal, in consultation with the Bundesbank, which went far beyond what the French had in mind: a single currency and common central bank preceded by further advances in convergence in the reduction of inflation rates and budget deficits as well as in the liberalisation of capital flows, and progress towards a political union.



# Ten years

United towards stable money

## **The Maastricht Treaty of 1992 – the involvement of the Bundesbank**

Thus, after more than 15 years of efforts towards a common monetary policy, proceedings in the European Monetary System (EMS), which were crucially shaped by the Bundesbank, gave a major impetus to the third attempt at integration of the past few decades – the establishment of a monetary union. The Bundesbank was closely involved in the preparatory consultations on the Maastricht Treaty between the governments of the EU. The then President of the Bundesbank, Karl Otto Pöhl, was a member of the Delors Committee, which wrote the blueprint for EMU, and chaired the Committee of Governors of the central banks of the member states of the EEC, which drew up the statute of the European Central Bank (ECB). Hans Tietmeyer, at that time a member of the Directorate of the Bundesbank, was a member of the EEC monetary committee which, among other things, framed the entry criteria for European monetary union. The fact that these criteria are defined quantitatively, and are therefore measurable, originated in a Bundesbank proposal. Helmut Schlesinger, who was President of the Bundesbank from August 1991, played a key part in designing the arrangements governing exchange rates in EMU; although the ECB was not given decision-making powers for the exchange rate regime, it was given such powers for foreign exchange interventions. Furthermore, the “general orientations” of the Council of Ministers for exchange rate policy are without prejudice to primary objective of maintaining price stability.

However much of the Bundesbank’s “model” was adopted (without which Germany would not have accepted monetary union), not all of its ideas were realised. It did not welcome the early date set for the launch of monetary union (1 January 1999), ie before certainty existed regarding the prospective participating countries’ fulfilment of the convergence criteria for entry into monetary union. When, in March 1998, the Bundesbank stated that 11 ERM countries fulfilled the criteria, it did so – in the assessment of Belgium and Italy – reluctantly with the help of expected values for fiscal policy. Nevertheless, the fixing of an irrevocable launch date in Maastricht was probably, after all, the price that Germany paid for France’s consent to reunification.

## **Pact and stability culture in place of political union**

Similarly, politicians ignored the Bundesbank’s wish to have monetary union gradually supplemented by a political union. The Bundesbank stopped campaigning for this, however, after the Stability and Growth Pact was adopted in 1997. The Pact set limits on general government new borrowing, thereby giving a fiscal policy underpinning to the stability-oriented single monetary policy. In one major area – fiscal policy – the Pact therefore appeared to make further steps towards political integration superfluous. Added to this was the consideration that, in a political union, monetary policymakers’ efforts to achieve stability can also easily be counteracted: price stability is put at risk if the common economic and social policies try to harmonise labour and transfer income at a high level. A stability-oriented monetary policy is facilitated only if policy makes incomes flexible and labour mobile. The individual countries can, however, succeed in implementing such a policy – even without political union – if they can rely on a stability culture such as that which increasingly began to develop in Europe following the negative experience of the “great inflation” in the 1970s and 1980s. However, a monetary stability culture of this kind has to be steadily encouraged and developed by all the member states of the monetary union. This will be essential for the continued success of EMU.

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