

## **Nout Wellink: Monetary unions in Europe and the US - just how different are they?**

Speech by Mr Nout Wellink, President of De Nederlandsche Bank and President of the Bank for International Settlements, at the Institut International d'Etudes Bancaires, Amsterdam, 17 May 2002.

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### **Introduction**

First of all, thank you for the invitation to speak to you today. Now that we have a monetary union, there has been discussion about the role of national central banks in the euro area, including some questions about their ongoing relevance. Clearly you regard us as relevant or you would not have invited me to speak! It will come as no surprise that I also think that national central banks are relevant, and will continue to be so. Today I would like to briefly compare monetary policy in the euro area and in the US. Of course there are differences between the two areas, but there are also important similarities. This comparison can help us understand the reasons behind our differences and may provide some useful insights into the institutional implications for euro area monetary policy in the future. I will structure my remarks around three themes: the policy goals of the two monetary unions, their organisation, and the monetary policy decision-making process in each system.

### **Goals and philosophy**

Let me begin by comparing the goals or mandates of the Eurosystem and the Federal Reserve System. Here in Europe the primary focus of monetary policy is to maintain price stability. In contrast, the Fed has multiple objectives for monetary policy. Their goals are to achieve maximum employment, stable prices and moderate long-term interest rates. An important explanation for our different mandates can be found by looking at our economic histories.

In Europe, monetary union is the most recent step in an ongoing process of political and economic integration. The hyperinflation experienced in the first half of last century in some European countries, in particular in Germany, has played an important role in ensuring that European monetary policy is focussed on price stability.

Our experiences in Europe contrast with those in the US. A key US event that commentators frequently refer to is the Great Depression. Monetary policy is often blamed for adding to the severity of the Great Depression in the US. I think that is a reason why employment and interest rate objectives remain in the Fed's mandate, and why policy makers there react so quickly to signs of slowing economic growth. Under normal circumstances, policy makers on both sides of the Atlantic are likely to take similar decisions. However, around the time that the economic cycle is changing and growth is slowing rapidly, you might see different decisions being taken in Frankfurt and in Washington - reflecting our different mandates.

In addition to the influence of history, the Eurosystem's mandate reflects academic insights from the last 20 years or so. This research tends to support the view that monetary policy should only focus on price stability. Other central banks around the world that have reviewed their mandates in recent years have tended to move towards having price stability as their sole objective. Similar proposals have also been made regarding the Fed. If the Fed's mandate were to change in the future, I expect it to also be in the direction of a more explicit focus on price stability.

### **Organisation of the two monetary unions**

A second area in which our different histories have played a role is in the way in which the Eurosystem and Fed are organised. While the Fed was created 'from scratch' by the Federal government for a single country, the Eurosystem was established when twelve sovereign states voluntarily gave up their monetary autonomy. This is reflected in the fact that the Eurosystem is some ways more decentralised than the Fed. Greater decentralisation is consistent with the EU-wide principle of subsidiarity, under which decisions are taken at the country or regional level where possible. This greater degree of decentralisation is apparent in areas such as monetary policy decision-making and operation, banking supervision and statistics. However, the Fed can also be considered decentralised in other areas. In

fact, when you exclude staff working on tasks unrelated to the monetary union, both systems have roughly the same number of employees. Clearly, this does not tell us much about the potential for efficiency gains, except that it is around the same in both systems.

The European monetary union is made up of sovereign countries. That means that it is not politically or publicly acceptable to carry out all central banking tasks at the ECB. Our preference for subsidiarity also implies that there are limits to potential efficiency gains within the system. The pace of further centralisation is linked to the speed of further political integration in Europe. As long as there is no federal European state, I expect that providing an independent view on national and euro area economic developments, within the context of area wide monetary policy, will be a key task for the Dutch central bank. Tasks related to financial stability and banking supervision will also remain part of our core business.

In order to carry out these tasks effectively, we have to remain closely connected to the formation of monetary policy. We also have an important role in explaining policy decisions to our citizens. Given the language, cultural and historical differences between countries, we should not underestimate the importance or difficulty of this task and the role of national central banks in carrying it out. These factors help explain the inclusion of national central bank governors in the ECB Governing Council, which brings me to my third theme.

### **Decision-making in the two monetary unions**

The final area of comparison between the Fed and the Eurosystem I want to make concerns the process of monetary policy decision making. Both areas include representation from regions as well as from the centre. But, it is clear that in this area the US also has a more centralised system than the euro area. Washington-based board members form a majority on the committee that makes US monetary policy decisions. In contrast, the ECB Executive Board members form a minority in the ECB Governing Council.

In both monetary unions, all decision makers, whether regional or not, are expected to make their decisions on the basis of prospects for the whole monetary union. This area wide approach is strengthened in Europe by ensuring that Council members are prohibited from taking instructions in their decision making. At the same time, national or European bodies are not allowed to put pressure on Council members. These provisions reinforce the fact that we are in the ECB Council on a personal basis, and not to represent national or other interests.

In a few years, the size of the euro area will probably increase significantly. As you will all be aware, European history also lies behind our desire for enlargement. Most accession countries have announced that they want to join the euro area shortly after entry into the EU. Whether they should join the euro area so quickly is a point we could debate another day. Regardless of our views on that issue, the fact remains that we have to be prepared for a substantial enlargement of the Eurosystem in the next five to ten years. Consistent with the provisions in the Nice Treaty, the ECB Council is preparing its proposals on changes to voting procedures to accommodate enlargement.

The reason for considering a change is to guard against the perception that our decision making could become inefficient, and that it could potentially be dominated by governors from small countries. In making changes, we must find a solution that retains the supranational character of decision making and does not renationalise monetary policy. This implies that the governors of all the national central banks should continue to be treated equally. At the same time, the Council must represent the Eurosystem as a whole, and be seen to do so - implying that it must not become too centralised. A solution that meets these criteria could involve some form of rotating membership for the governors of the national central banks, so as to limit the number of voting governors. This could be a variation on the Fed system, albeit more decentralised. There, all of the regional presidents participate in the discussions, but not all of them have a vote at any point in time. Finding a solution that meets the criteria I have set out is especially important, given that changes here could set a precedent for other areas of supranational European co-operation

### **Concluding remarks**

Let me briefly conclude. In my view, differences in mandates between the Fed and the Eurosystem are important in understanding our respective decisions, and this is often forgotten. In addition, comparing the two systems sheds some light on where each institution may head in the future. Regarding our

mandates, it seems to me that any changes in this area are likely to be in the direction of the Fed moving closer to where we and other central banks are, rather than the reverse. For organisation and decision making, the future is more difficult to predict. Any changes here need to take account of the political realities of monetary union between sovereign countries. Euro area monetary policy is supranational, so decision making has to be based on the euro area as a whole, and not individual countries. At the same time, the euro area consists of independent countries. That implies that there is a limit to how far the Eurosystem can centralise in advance of any political union. This reality has to be clearly reflected in our decision-making body.

I wish you success with the rest of your conference and an enjoyable stay here in Amsterdam.