3-2000

Introduction to a Symposium on Central Banks after EMU

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Published In
Atlantic Economic Journal, 28, 3.
Introduction to a Symposium on
Central Banks after EMU

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The start of the European Central Bank in 1999 is often compared to the start of the Federal Reserve System in 1913. There are similarities. Both started as federal systems with substantial operating responsibilities at the regional or national levels. Both left important responsibilities to the regions or nations.

There are many differences, not the least of which is that the European system incorporates national central banks with long histories of successful operations. In contrast, the Federal Reserve System created de novo regional banks several of which were too small to be efficient. The designers of the Federal Reserve System believed that each Reserve bank would operate as a semi-autonomous institution, setting its own discount rates and cooperating in portfolio decisions only when it chose to do so. This feature survived on paper, but only partly in practice, until 1936, when legislation centralized control and authority. Nevertheless, as late as 1932, individual Reserve banks declined to participate in open market operations.

The designers of the European system did not repeat this mistake. Decisions are taken collectively, but they are binding on the members. The members--currently 11 countries--implement the common policy within their nations, but there is only one, common, short-term interest rate for the region.

The Federal Reserve Act tried to provide for regional differences by permitting limited regional autonomy. The European Monetary Union makes no provision for regional differences. It remains to be seen how large these differences become and how they are resolved.

Although the original Federal Reserve System was a looser federation for policy purposes, membership was not optional. The United States then, as now, was a single country
with a single language and a common national law. The European system, in contrast, brings
together countries with different traditions, different laws regulating banking, finance, payments,
and other relevant features. Further, countries can choose not to join the new system, and some
EU members have. But even those that do not join are affected by the new arrangement.

The symposium brought together three experts from central banks that are affected very
differently. Germany has ceded some of its authority over monetary policy to the other members
of the monetary union. Previously, the Bundesbank kept its eyes and ears open to the problems
of its neighbors, but it was not obligated to alter its policy or listen to its neighbor's complaints.
The Bundesbank controlled the inflation rate. It was for the others ultimately to decide whether
to accede to the Bundesbank's policy or to let their exchange rate adjust.

Heinz Herrmann's comments bring out how the new system has changed some internal
operations of the Bundesbank. Committees representing all member countries have more
influence on the common policy. Herrmann also shows that the new system has started to
influence banking and regulatory policies, though these policies remain under the control of the
national members.

The mirror image of the reduction in Bundesbank influence is the increased influence of
the smaller national banks. Eduard Hochreiter of the Austrian National Bank explains that,
before EMU, the Austrian National Bank fixed its exchange rate to the DM. With the arrival of
EMU, Austria still has a fixed exchange rate, but it can influence the policy decision with voice
and vote and, also, with independent research effort. The Bank has not limited its role to
describing conditions in its own domain; research analyzes conditions in the European Union,
especially the eleven member states of the monetary union.

Switzerland is not a member. After EMU, as before, the Swiss National Bank conducts
an independent policy. Georg Rich's paper brings out the increased role now taken by the
Euro/Swiss franc exchange rate. Swiss prosperity and low inflation depend on what is
happening in its unified neighbor. Exchanges between its neighboring countries were formerly
free to adjust, now they are rigidly fixed. Hence, they have much greater weight in Swiss policy.
The Swiss National Bank tries to retain its independent policy, just as Canada maintains an
independent policy instead of fixing its exchange rate and accepting the monetary policy of its
larger neighbor.
One common theme found in the three papers is that establishment of the European Central Bank has changed the role and activities of national central banks but has not reduced them to mere branches. A second common theme is that major institutional changes are not one-time events. New arrangements call into question many pre-existing arrangements and, often, require changes in these arrangements.

The Federal Reserve System did not acquire its current formal structure for almost 25 years. It modified and changed its operations, degree of centralization, transparency, research effort, and many other features in the next 62 years.

The papers in the symposium teach us much about the start of this process as seen from three very different perspectives. Students of central banking, monetary policy, and institutions will find them worthwhile and informative.