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The European Integration Process: A Changing Environment for National Central Banks

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The European Integration Process: A Changing Environment for National Central Banks

Keynote Speech

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I am back into a central bank after a few months; a very short period for most of you, a very long one for me. When a big change occurs in ones life, time slows down. This in a way helps me approaching the subject you have suggested to me from a certain distance. I do not think my views on the topics covered by the title have fundamentally changed in the last four or five months. And some of you may have heard some of them already. But maybe the flavour is not exactly the same as if I were still wearing the hat of an active central banker. My address will be about the general title of the workshop "The European Integration Process: A Changing Environment for National Central Banks", but some of my reflections will be broader, because I think, the environment and even the nature of central banks is changing *irrespective* of the European Union (EU). The EU is a change within an historical trend, which is also affecting your central banks, the Eurosystem and the European Central Bank (ECB). To distinguish between this deeper trend and the specifics of the Eurosystem and the national central banks in the EU is not always easy, but it is necessary to avoid misunderstandings.

The two adjectives that appear in the title are *national* and *central*. They have a clear historical meaning. The National Central Bank, *the* central bank, is a monopolist. It is a bank which has the exclusive right to issue banknotes. The banknotes are the only form of money which is fully protected by the law. Whenever banknotes are used to pay for an obligation, the creditor has no right to refuse them as a means of settlement.

It is called *national* because to issue the currency is a prerogative of the state and the state has been for approximately two centuries the nation state. It used to be a dynastic state and has become based on the idea of the nation only in the course of the 19th century. It is called *central* because of its uniqueness, but also because –

in most cases – the model of the state was a centralised one, where power would be concentrated at the centre. It is a historical development, which has been brought to its highest manifestation by the idea of the Jacobin state, which concentrates all the power. Therefore, central banks are qualified by all these elements in a historical context.

In the EU, however, we have different meanings for these two words.

Now, the central bank of the euro (which we call Eurosystem) is not national, to the extent to which Europe is not seen as a nation. It is not centralised, because it has a federal structure. In the Eurosystem, the word *national* comes to mean something which is almost opposite to what it used to mean for a central bank. In the historical tradition of central banks, *national* means the *whole*, the one and only central bank in the monetary jurisdiction, which coincides with the state. But here in Euroland it refers to a *component* of the central bank of the euro, which is a composite including national central banks. The central bank of the euro (like that of the U.S. dollar) has the name of *system*, not the name *national* or not even the name of a central bank as a singular noun. And system is defined by the dictionary as a set of interrelated components which form a single whole.

To sum up, one could say that the meanings of the two adjectives (national, central) accompanying the noun *bank* are profoundly different in the traditional and in the present context. In the EU environment, the difference in meanings encompasses everything that can be said about the topic.

As I was saying, central banking is changing irrespective of the EU experience. One could even say that the EU experience would not have been possible without a broader change in central banking and in the economic and financial environment. Had the environment remained the one of the time in which the traditional meanings of *national* and *central* developed, probably it would have been impossible to reach a consensus for creating the euro and its central bank.

Thus, let us look at how central banking is changing in this broader sense. Here I would say that it is not just the *environment* of central banking that is experiencing changes. It is central banking itself that is changing in its natural function. And it is changing worldwide, not only in the EU.

Let me first sketch the changes we have seen in the two types of economic regimes that characterise the countries present in this room; centrally planned economies in the Soviet block, on the one hand, and market economies in the West, on the other.

Regarding the former, in communist countries there was no separation between central banking, commercial banking and the state budget. In addition of being the issuer of the currency, the central bank was the agent of the state budget and the single commercial bank of the economy. This was not long ago. The separation between the three entities has been extremely complex and very hard to achieve even conceptually.

Let me note in passing that it would be a mistake to consider integration of central banking, commercial banking and budget functions as only a characteristic of the communist experience. There were elements of it also in Western countries. First a central bank which is not independent, but more or less a branch of the Treasury, tends to be called to exert functions which are ancillary to the budgetary process rather than to the monetary management process. Second, in many countries there are financial institutions, in which the central bank is directly involved. In my own country, for example, some of the large state banks had until recently in their governing bodies a central bank representative. In some countries, even today, we see a lack of distinction between central and commercial banking. For example, the central bank still has private clients, which have their central bank account. The entangling of the three components is most pronounced it centrally planned economies, but it is not their exclusive experience.

If we turn to Western countries, we also see a big change. Central banks used to depend on the Treasury. For many decades, they had little national sovereignty and little institutional independence. On the one side, there was the very strong idea that printing money is a prerogative of the sovereign. On the other side, the basis of the value of money was gold, something that was not really controlled by the sovereign. Some manipulations were possible but up to a limit. Money thus had a very strong international dimension, which lasted until about thirty years ago. Even economists of liberal tradition, were in favour of a strong international dimension of the currency. Today, when an eminent economist like Robert Mundell pleads for a world currency the reaction of central bankers and a large part of the economic profession is to find the idea fancy and unrealistic. But strictly national currencies have existed for very little time. Hayek was in favour of a strong international dimension of currencies and opposed what he called monetary nationalism.

The idea of a strong national role is relatively recent and not fully tested in reality. I have checked how many of the central banks here had the word *national* in their name. A few of them do, and in general these are young central banks: central banks that have emerged from the breaking up of a larger entity like the Austro-Hungarian empire, the Soviet Empire, the Federation of Yugoslavia, the breaking up of Czechoslovakia. The older central banks – in the Netherlands, in the United Kingdom, in France, in Spain and Italy – do not carry this name, because in a way there was no need to emphasize the national character, which was not part of their genetic code.

In Western countries we have experienced an increased nationalisation of central banking due to the floating of exchange rates, the end of the gold standard and the relaxation of any form of international discipline, except for the discipline imposed by the international market. And in the meantime we have seen the tendency towards independence from governmental bodies.

These different trends depend on whether or not a central bank went through the experience of central planning and socialism. But, of course, the two also have elements in common.

There are trends, which affect the *organisation*. In most countries central banks are rapidly closing their branches. The Bank of England has no branches and has less than, I think, 1,500 employees. But, on the other extreme, the Banque de France still has, or had until recently, over 200 branches. De Nederlandsche Bank has cut down on branches and the Bundesbank is rapidly closing its branches.

In the euro area there is a tendency to present such changes as an implication of the euro, because of the bad habit to use Europe as the cause of whatever is unpopular or difficult to implement or communicate at the national level. But the shrinking of the organisation of central banks has nothing to do with the euro. The United Kingdom is not in the euro and it is in the forefront of the change. The shrinking is primarily due to technology, but also has to do with the changing relationship between the central and the commercial banks.

Another trend is the change in the *institutional setting*. The exit of the central bank from the influence of the Treasury is very recent and closely linked to the advent of the euro. Before the Treaty of Maastricht, institutional independence, formalised in the statutes and in the law, existed only in Germany and, to some extend, in the Netherlands. It was completely absent in the United Kingdom, in France and Italy. Statutory independence, the very idea that statutory independence is possible and desirable, was developed conceptually in the same period in which the idea of a single European currency was gaining ground. It was fully implemented in the Treaty of Maastricht. Treasuries would have not relinquished their grasp over the central bank, had it not been as part of the acceptance of independence. And independence of the national banks came as an implication of the Treaty of Maastricht.

The *analytical framework* defining the notion and the tasks of central banks has also evolved, in the sense that increasing focus was placed on the monetary policy function of central banks. This too is a recent phenomenon. Central banks were not created to conduct monetary policy. Indeed even the notion if it was unknown when central banks came into existence. Over time, monetary policy came to be gradually identified as something very specific and increasingly acquired prominence to the point of almost identifying the central bank as the entity in charge of monetary policy. Other crucially important currency-related functions of central banks in the field of financial stability, supervision and payment systems came to be seen as functions of second order.

The Eurosystem is sometimes close to the extreme of viewing itself as an entity only in charge of monetary policy. Some national central bankers occasionally seem to consider that all other tasks of the national central banks have been left unaffected by the advent of the euro and their becoming part of the Eurosystem. I think this is a clear mistake.

The changes I have just mentioned are part of a trend that deeply effects the environment in which national central banks in the euro area operate, but are *not* specifically European trends. It is because of these trends that the creation of a single currency for a group of states (a group which is not itself a state and not even the loosest federal state) was possible. This change is of enormous magnitude for the environment of central banks in the euro area and it triggers a new evolution which is the subject of your workshop.

When the European Economic Community (EEC) started in 1958, we were fully in the world I have described at the beginning of my presentation. Gradually, things evolved. The EU moved from being tied to an external anchor (the U.S. dollar) to an internal anchor (the Deutsche mark), to having its own single currency, the euro. It has moved from the universe of *international* monetary relations, which are typically based on an exchange rate regime, to a typical *national* model, namely one currency – one central bank.

The first of the three regimes lasted for the first 15 years of the EEC from 1958 to the early 1970s; the second for 25 years; the third started in 1999. It is interesting to note that all the three regimes still exist in the EU. Indeed we have countries which are in the first, in the sense of not belonging to any special monetary arrangement of the EU, except the article – which is in the Treaty since 1958 – stating that exchange rate matters are to be treated as *matters of common interest*. The second regime, is the one applying to the currencies belonging to ERM II. The third regime includes the countries participating in the euro area. It is like seeing the rocks belonging to different geological areas still visible within the EU.

Now, what is typically European in all this and what makes the environment special for national central banks? One element is that national central banks are part of a system, which is far more independent than any previous one. I describe it sometimes as a state of solitude rather than one of independence, because there is nobody to be independent from. Within a country (take the United Kingdom or the U.S.A.) the central bank is independent, but there is a government from which it is independent. In the EU there is more than independence. There is absence of a counterpart. In addition the independence is constitutionally based. It is written in a treaty that is virtually impossible to change. Maybe unanimity in an EU with 25 members is a way of locking the statutes even too much.

The Eurosystem is peculiar also because banking supervision remains largely, although not entirely, a prerogative of the subcomponents of the euro area, namely a national prerogative. Hence it is not just like in the United Kingdom, where for the same territory you have two authorities. Here the authorities have jurisdiction over different territories.

Finally, the Eurosystem is an expanding central bank. It gears an economy that is enlarging further.

What I have been saying sets the stage for the different panels of your workshop. The *euro*, the *Eurosystem* and the *changing position of national central banks* mark a development that concluded the creation of a single market. In a way, they represent the endpoint of a process of forty years. However, in another respects, this is only the starting point of another process of change: having become components of the Eurosystem rather than stand alone entities, central banks are bound to transform themselves.

The question of how national central banks will have to evolve is indeed a crucial one, and one full of unknowns. The evolutionary path has to be invented.

We can imagine two extremes. One consist of imagining that the single currency implies, pardon the expression, destroying the national central banks, closing them down and replacing them with an entirely new institution. This is unconceivable in a vast multilingual euro area. It is unconceivable that there could only be the centre. The Bank of England has no branches, but the euro area could never have only an entity at its centre.

At the other extreme, we can imagine that national central banks did not change at all, that they consider the euro as just a small accident that disturbs a little bit their life, but not too much, and that business should continue as usual. It is a caricature, but sometimes one hears statements which are not far from it. This other extreme would also be completely ridiculous. National central banks were what they were on the first of January 1999, when the euro started, precisely because they were stand-alone-entities. They would never have taken the shape they had at that moment, if not because they were *central* and *national* in the sense I have described at the beginning. So it's true almost by definition that a large number of those characteristics are incompatible with being part of a system in the new mode. A number of the characteristics of national central banks are incompatible with the advent of the Eurosystem, but certainly not their existence.

I think that the issue of today's workshop, and a challenge for any central banker in Europe today – whether in Frankfurt or in the capital – is to see what the further evolution and change of central banks will be. I would not say, as the title suggests, only a changing *environment*, but a changing *model* of national central banking.

Thank you.