GERMAN INFLUENCE ON THE EU MONETARY POLICY

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Introduction

Germany has always been showing its dominant position in all levels of the European Community economic life. It was the first of the founding Member States that introduced foundations of the competition policy; it was a leader in the monetary relations within the Community. Germany emerged successfully from the post-war crisis and put its currency on a dominant position in Europe.

The main feature of German monetary policy is the independent central bank – the Bundesbank. It is obliged to the U.S. as it was completely their initiative to give such independence to German central bank. With a strong Bundesbank and monetary system Germany played the key role in the negotiation process of the creation of the European Monetary Union. That is why the main aim of the article is to show the influence of Germany on the creation of the EU monetary policy.

Nowadays Germany still has a significant influence on the policymaking of the European Union what naturally has its historical background. This background explains us why Germany is so important not only in Europe, but also in the world.

The question of monetary policy in Europe has always aroused great interest among academics. It is not surprising that there are many publications on this subject and the role of Germany in it.

Dorothy Heisenberg (1999) examines the relationship between the Bundesbank and the Federal Government of Germany, and their preferences at the international level. The author describes the development of the European monetary cooperation and Germany's role in it. The views of Peter Heisenberg have been in some way extended by Peter Loedel, who examined the role of the Deutschmark in the creation of the European Monetary System (Loedel, 1999).

Otmar Issing (2001, 2011) is the author of numerous articles and books on the monetary policy of the EU and Germany. In one of his recent papers he examines the lessons from the financial crisis for EU monetary policy.

Lucia Quaglia (2008) conducts a comparative analysis of three European banks: Bank of England, Bank of Italy and the Bundesbank as well as determines European Central Bank as "a new experiment system of central banks".

Kirstin Hubrich (2001) believes that the German monetary system is a good example for the European monetary system for four reasons: firstly, economic actors in Germany will always be playing a significant role in shaping monetary policy of the EU, as Germany has the most powerful economy in the Community; secondly, Germany has played a significant role in shaping the European monetary system, because the German mark was its anchor currency; thirdly, the European Central Bank (ECB) was largely modelled from the German Bundesbank; and fourthly, thanks to the success of German stability policy, the ECB has given a prominent role to money in its monetary policy.

Methodology. In order to study the field of monetary policy in the EU and Germany there were used such methods as historical and comparative analysis, synthesis and conceptual analysis.

Results of Research

Bundesbank – the Main Engine of Monetary Policy of Germany

After the war and the division of Germany into four occupation zones, Reichsbank ceased to exist. On the initiative of the U.S. in two occupation zones (American and French) central banks of the federal lands have been established. The British zone joined only when the U.S. agreed to establish a Bank of German States (*Bank deutscher Länder*) in 1948. Federal structure of this system in general was very similar to the U.S. Federal Reserve System.

Chairmen of the Land central banks constituted the board of the Bank of German States (Touffut 2008, p. 27). The newly established monetary institutions were not the subject neither to the government of their states, nor to the government of the Federal Republic of Germany. So in that sense they were independent institutions. However, in order to control the new monetary system, allies established the Allies Bank Commission (ABC), and thus all important decisions had to be approved by this Commission. It is symbolic that the office of the Allies Bank Commission was on the top floor of the headquarters of the Bank of German States in Frankfurt.

Independence of the Bank was extremely applauded by German people, and it is not surprising

that both the Bank of German States and the Allies Bank Commission agree that the government access to bank loans should be strictly limited.

Concerning the Allies Bank Commission, it existed until 1951 when it was dissolved. The central bank instead pledged to maintain overall economic policy of the government "within its authority".

But in 1951 the independence of the Bank of German States was threatened. The Chancellor of Germany Konrad Adenauer expressed concern that central bank independence would lead to a "state within a state" as it was during the Weimar Republic. However, despite all the fears the Bundesbank law was adopted on 26 June 1957. Under the new law, the central banks of the federal lands retained their names, but merged with the Bundesbank and became its main office in each land. The difference between the Bundesbank and the central banks of the federal states was that the latter had no right to issue banknotes, and they served as a lender of last resort for the banks in their states. The law guaranteed the independence of the bank from the government guidelines. Such measures contradicted in some way the German tradition, and were likely the result of demands from the allied countries. However, the independence of the bank was still somehow limited, taking into consideration the fact that, although formally members of the Directorate and president of the Bundesbank were appointed by the Bundesrat, while nominally they were appointed by the Government (Toniolo 1988, p. 143).

Bundesbank is one of the most independent central banks in the world. This is a strong domestic and international actor, which after the World War II took over leadership, held by the Bank of England (Quaglia 2008, p. 47). The Bundesbank was independent of government authority from the very beginning of its foundation in 1957. Its main task at that time was to protect national currency, greatly weakened after the war. This task was incorporated in the basic law "Bundesbank Act" (Bundesbankgesetz). Protection of the national currency had two components: exchange rate stability versus to internal price stability, and the interaction of monetary policy (first of all, price stability) with other macroeconomic policies (first of all, growth).

Peter Loedel identifies three dimensions of German Bundesbank independence:

- Political independence (freedom to choose a course of action);
- Personal independence (Federalist government structure formation, which was borrowed by the European System of Central Banks);
- Financial independence (loans, federal reserves, interventionist requirements) (Loedel 1999, p. 44).

However, the independence of the Bundesbank is sometimes limited by German Government. For example, during the period of the Bretton Woods system the responsibility to establish parity of German mark belonged to the government. The Bundesbank provided only the recommendations to the government on this issue (Touffut 2008, p. 32). After the collapse of the Bretton Woods system there were proposals to expand the range of monetary policy instruments and in 1972 the Bundesbank even asked the government to authorise it to require minimum reserves of commercial banks, but these requirements were not fulfilled at that time.

As in the first half of the twentieth century Germany suffered from high inflation, it is not surprising that price stability was one of its main economic goals. This explains the limited monetary and fiscal policy, which maintained imports and inflation on the relatively low level. The strategy was based on a fixed exchange rate, without self-regulating gold standard including freedom of capital flow. Fiscal policy was aimed at guaranteeing export credits and constant budget surpluses, which arose due to the deposits in the central banks, which helped to reduce domestic demand. In addition, fiscal policy encouraged private savings through tax breaks and other subsidies that dampened domestic demand. This successful strategy is called "German mercantilism". It can be characterised by positive current account during 1952–1961. Germany not only continues to lead this strategy but it gave it as a legacy to the European Central Bank (Touffut 2008, p. 36–37).

The main objective of the Bundesbank is based on the monetarist principle that monetary expansion determines the movement of prices in the medium term. Thus, money supply is particularly well suited to the role of nominal anchor in the policy of Germany's central bank, which is based primarily on the support of price stability (Frowen 1998, 34).

The Bundesbank exercised indirect control over the money stock. Its ideas on monetary regulations were quite "conservative". They were aimed at regulating credit supply of banks and non-banks' demand for money and credit indirectly by changing the banks' liquidity and the mechanism of interest rates in the financial markets.

Before the 1970s, the traditional instruments of the monetary policy in Germany were the rediscount, Lombard and minimum reserves policies; by contrast the open market policy has become of a large value only at the end of the 1970s. The rediscount policy means that the Bundesbank buys trade bills from the credit institutions at the discount rate. This rate is usually slightly lower than rates in the money market and, therefore, contains a "subsidy element". As a

result, the total rediscount credit available to each bank is limited by rediscount quotas. Lombard loans are granted by the Bundesbank against the collateral of certain securities and Debt Register claims. Unlike the rediscount loans, they were not intended as "a permanent source of funding", but rather as loans for very short-term liquidity. Thus, the Lombard loan rate was always higher than the discount rate.

In the 1970s Bundesbank shifted its attention towards the price stability by adopting the European version of monetarism. Interest rates and bank liquidity through open market operations, refinancing policy and determination of the amount of minimum reserves were the main instruments of this policy (Quaglia 2008, p. 65). This objective was also adopted by the European Central Bank.

Social market economy in Germany is characterised by a strong connection between banks and industry. Corporate governance supports insiders and cross-shareholding, as well as encouraging the representation of banks on the supervisory of firms vice versa. This means that the banking and industry sectors have the same political preferences, although this tradition began to change in the 2000s.

Ordoliberalism and the European Monetary Union

The Bundesbank was in the epicentre of the institutional ordoliberalism, and therefore the demands to attract it to the financial negotiations on the European Monetary Union were a guarantee that the ordoliberal ideas would make German policy dominating in the European Monetary System (Dyson K. and Featherstone 1999).

Through German policy, ordoliberalism had a great influence on the EMU in three directions. Firstly, it stated that the EMU should be a "sustainable community" which should be based on the economic convergence. This means the Europeanisation of the German model of economic stability through: the absolute priority of the principle of open and competitive market; independent European Central Bank, which is tied exclusively to price stability; rules that do not provide any liens and do not prohibit monetary financing of budget deficit; and, of course, strict, and automatic rules of fiscal discipline. Germany strongly emphasised on the strict interpretation of the convergence criteria of the Maastricht Treaty and the rules of the Stability and Growth Pact.

Secondly, ordoliberalism opposed "explicit" formal policy coordination at the EU level. Specific policy issues had to be clearly divided among various entities responsible for their decisions. Economic growth and employment should be the subjects of government supervision, and the price stability is the concern of the ECB, and none of these institutions should intervene in the affairs of the other. In general, ordoliberals were unhappy about the "coordination" of the economic policy at the EU level by providing greater benefits to the "dialogue" and "cooperation". They were particularly cautious to the French "economic governance", referring to a more active policy of exchange rate against euro, and referring to the "Euro Council" rather than "Euro Group" which would have only a formal status of the decision-making body, and would be the mechanism that reduce central bank independence. Thus ordoliberals emphasised the principle of subsidiarity in economic policy, the responsibility of the Member States for growth and employment, and competitiveness of national policies. At the same time they noted that the monetary policy aimed at price stability should be supported by appropriate economic policies.

Thirdly, ordoliberalism emphasised that a strong euro depended on the ability of the EU to present itself as an "independent political entity" (Deutsche Bundesbank 1990, 2001, 26.7). That is why, the EMU required accelerating the formation of European political union strengthening the activity of the Community institutions and increasing the effective coordination in such areas as foreign policy and security, environment, internal politics and justice (Dyson 2000, p. 178-179).

The Influence of Germany and the Bundesbank, in Particular, on the Formation of the European Monetary Union

Many academics and politicians consider the European Central Bank a clone or twin of German Bundesbank. The Bundesbank was very active in the negotiations on the establishment of the European Monetary Union that led to the execution of the Maastricht Treaty and the withdrawal of the criteria of participation in the EMU.

The talks about a monetary union in Europe began in the late 1960s. Thus, in 1969, on the Hague Summit the Member States agreed to establish Werner Committee (Prime Minister of Luxembourg, Pierre Werner, was the head of the committee) with representatives of all EU Member States (France, Germany, Italy, Belgium, the Netherlands and Luxembourg). The committee had to develop a plan of the monetary union. It consisted of the heads of the Monetary Committee (established under Article 105 of the Treaty of Rome), the Committee of Governors of Central Banks (founded in 1964) and three other committees, as well as the representatives of the Commission. It was not easy for the countries to reach consensus, and the situation got more complicated

in the last year of the functioning of the Bretton Woods monetary system (it was cancelled in August 1971), in which all countries tied their currencies to the U.S. dollar. Then, in May 1971, Germany made a decision to float against the dollar. However, the floating exchange rate in Germany lasted less than a year because of a significant wave of speculation with the capital. Therefore, Germany offered the Member States of the Community to establish a joint float against the dollar. It was supported by the Netherlands and later by Italy. France had a fear of being tied too closely to the DM, and decided to establish a two-tiered exchange-rate system. The Benelux countries agreed to float together because of the strong ties among their economies (Heisenberg p. 24–33). Only during the global monetary crisis at the end of 1971, Germany and France concluded a Smithsonian Agreement, according to which they agreed to float against dollar within newly established parity bands (2.25 percent).

The Bundesbank and the German Finance Ministry were critical about exchange-rate co-operation, fearing that this in turn can lead to "inflation community" (Quaglia 2008, p. 63). As for the paradigm of the exchange rate, its main elements are: the conviction that European or international agreement on the exchange rate should not affect the domestic monetary policy (which could affect the policy of the Bundesbank or put the face on its autonomy); the preference of floating (or semi-floating) exchange rate; and the reluctance to use market intervention to defend the exchange rate.

In early 1972, the EEC Commission returned to the issue of the European Monetary Union. The countries agreed that their currency would fluctuate within ±2.25 percent relative to other currencies of the Community. This agreement was called the "snake in the tunnel". At that time Germany was getting more and more influence in the monetary policy of the Community, that is why it is not surprising that Otmar Emminger's proposal (the president of the Bundesbank 1977–1979) to authorise exchange rate fluctuations against the dollar was perceived positively by most countries of the Community (except the UK and Italy) (Heisenberg p. 39).

Due to the instability of foreign exchange rate position in France in 1974–1976, it had to leave the tunnel twice that meant that the "snake in the tunnel" became a stable block of the Deutschmark. For Germany, instead, the "snake in the tunnel" proved to be useful in maintaining the exchange rate with some of its trading partners. However, in general the "European monetary snake" was ineffective, as the monetary policy of the EEC was not coordinated.

In 1978, after the series of negotiations among the leaders of the EEC, the Chancellor of Germany Helmut Schmidt and French President Valéry Giscard d'Estaing, it was decided to establish the European Monetary System which would be brought into action on 1 January 1979. An Exchange Rate Mechanism and the European currency unit, ECU, was the basis of the European Monetary System. At the same time, the European Monetary Fund was established by the proposal of Helmut Schmidt (Heisenberg 1999, p. 78).

The Exchange Rate Mechanism was based on setting fixed limits of currency fluctuations to the newly created monetary unit, ECU, which was determined as the weighted average of all rates of the participating countries. The exchange rate bands were ± 2.25% for all countries except Italy (6%).

In 1986, the German mark strengthened its position, which was caused by the fall of the dollar. In 1987 at the meeting in Nyborg (Denmark), the EU finance ministers announced changes in the EMS, which were stated in the report of central bankers. The changes consisted of five measures: (1) proper use of the interest rates differences, (2) more flexible use of fluctuation margins, (3) assurance that the reorganisation of the EMS will be infrequent as possible, (4) expansion of the possibility of financing the European monetary system and (5) agreement that price stability is the norm around which the EMU will be built. These measures reflected the influence of the Bundesbank on the formation of the EMU rules, excluding paragraph 2, which is quite contrary to its vision (Heisenberg 1999,p. 91).

Thus, the period from 1982 to 1992 is characterised by focusing on the German mark which served as "anchors" currency. For the Bundesbank, the success of EMS regime proved to be very favourable in the 1980s. EMS rules laid the groundwork for a system that was acceptable to the Bundesbank. Market forces have established the role of the Bundesbank in this system. Although other Member States have found their place in the internal hierarchy, the Bundesbank had the dominant position within European central banks. In addition, the Bundesbank became involved in the international negotiations – either through its contacts on the Committee of Central Banks Governors or though the Bundestag as its agent, in the Franco-German Economic and Financial Council.

In 1988, the President of the European Community Jacques Delors and the Chancellor of Germany Helmut Kohl brought a powerful Committee of European Community Central Bank Governors into a prominent role in the planning of the European monetary union. Other bodies involved in planning of the EMU were ECOFIN which was composed of the ministers of economy and finance and the EC Monetary Committee whose members were representatives of finance ministry and their counterparts from the central bank of each state (Touffut 2008, p. 40).

The idea of the creation of the European Central Bank belonged to Germany's Minister of Foreign Affairs, Hans Dietrich Genscher. This idea was supported by the European Community President Jacques Delors, Chancellor of Germany Helmut Kohl and French President Francois Mitterrand. On their initiative Delors Committee was created. It was formed by the presidents of all central banks of the Member States. In April 1989 the Committee published Delors Report, according to which the European monetary system should be implemented in three stages.

It was noted in the report that the establishment of the monetary union was a long-term goal, but it already stated some principles of the European Central Bank. The Delors Committee affirmed that the European Central Bank should have a federal structure as the Bundesbank, and that it should have as much independence as possible, and its main objective should be price stability.

According to the first stage of Delors Plan which had to begin its work on 1 July 1990 (and it was agreed at the Madrid Summit of Council of Ministers in June 1989) involved a single financial area with a free market of financial services and the free circulation of capital, the inclusion of all Member States currencies in the European Exchange Rate Mechanism, removal of the obstacles of ECU private use and strengthening of the existing Committee of Central Bank Governors (Loedel 1999, p. 102). The second stage involved amendments to the Rome Treaty that concerned the establishment of the European System of Central Banks (ESCB). The ESCB should have absorbed the existing institutional mechanisms in order to shift from coordination of national monetary policies to the development and implementation of the Community monetary policy. ESCB would be independent of national governments and other institutions of the Community. During this phase margins of currency fluctuations would be narrowed, in preparation for the transition to zero in the final stage. Stage three or the final stage of this process involved the irrevocable fixing of exchange rates and the assumption by the European Central Bank full responsibility for monetary policy and intervention in the foreign exchange market in the third currency.

In the final stage of Economic and Monetary Union, the Bundesbank required several statutory elements. According to the remarks of the Bundesbank, the European central banking system should: give priority to monetary stability; have guaranteed independence; largely involve national banks as an integral part of the ECB (they no longer have the right to pursue its own policy); have a council (which sets monetary policy objectives) and board (which would implement these goals). The Council should consist of the representatives of national central banks and governments; have all the necessary tools of the monetary policy; be responsible for the foreign exchange market; not be obliged to provide loans to state institutions.

Bundesbank warned that the long transition process will be needed to achieve the final stage of the EMU. It established the following criteria for the third stage:

1. Anti-inflationary policy must have converged so that the differences in prices have been eliminated, the budget deficit reduced to an acceptable level and capital market interest rates harmonised;
2. All members of the EMU should fully participate in the exchange rate mechanism and have liberalised capital movements;
3. The statute of the national central banks should be harmonised so that they could become an integral part of the European System of Central Banks. This also applies to the instruments of the monetary policy;
4. The contractual agreements on budgetary discipline in all Member States should be adopted at the Community level;
5. The single market programme must have been fully implemented, including the dismantling of border controls.

Heisenberg (1999) states that the Bundesbank requirements demonstrate its uncompromising stance and that is why all the guidelines (except the last paragraph) were included in the Maastricht Treaty.

The German Bundesbank model, with its reliability and good reputation of the central bank and the German mark as one of the leading world currencies, was proposed as a model for the institutional arrangements of the European Central Bank. As German currency was a key currency in Europe, it is not surprising that German people were against the move to single currency, as they could trust the central bank more than the government. To achieve such level of trust was and is the main objective of the ECB.

As the German central bank, in terms of price stability, was the most successful and independent within all European central banks, the Bundesbank demanded at least the same independence for the ECB. In fact, the ECB was made more independent than the Bundesbank (the German government could veto decisions of the Bundesbank for two weeks, and basically it could just change the Bundesbank statute. At the same the ECB decision cannot be vetoed and it is not easy to change its statute).

After the demand of the Bundesbank, the

Maastricht Treaty contained the convergence criteria for the monetary and fiscal development that the Member States should have performed in order to access the final stage of entry into the European Monetary Union. The EMU inherited also German monetary approach based on the economic supply (Germany has been carrying out this policy since 1970 after the transition to floating exchange rate), giving up the attempts of France to impose their expansionary Keynesians policy (Touffut 2008, p. 42). Neither of other French demands to centralise other areas of economic policy has found the support in the Community. On the other hand, the Maastricht Treaty also did not reflect the items of the economics supply (offered by Great Britain and Germany) which concerned the principles of labour market and wage flexibility, and a commitment to privatisation.

Instruments of the Monetary Policy in Germany and the EU

While comparing the instruments of the monetary policy of the Bundesbank and the ECB, there are obviously some similarities worth noticing. As noted above, the main instruments of the monetary policy in Germany include refinancing policy and strong emphasis on minimum reserve requirements. In addition, a prominent feature of the latter instrument is that the minimum reserves requirement must be met within the four-week term. This in turn gives the commercial banks the possibility to cover their bank liabilities. Such relatively large intervals allow a large number of credit institutions to participate in the Bundesbank operations on the open market (Menkhoff 1997, p. 25).

Now the ECB uses the same instruments of the monetary policy: open market operations; standing facilities (e.g. refinancing); minimum reserve requirements for credit institutions.

The ECB Directorate states that open market operations play an important role in the management of interest rates, liquidity management in the market and signalling the monetary policy stance.

Standing facilities are aimed at ensuring and absorbing the short-term liquidity, signalling the overall monetary policy and bounding short-term market interest rates. There are two types of standing facilities which are administered by the national central banks of the Member States – a marginal lending facility (is used for obtaining short-term liquidity from NCBs) and deposit facility (is used for making short-term deposits with the NCB).

The main tasks of minimum reserves are stabilisation of money market interest rates, creation (or enlargement) of a structural liquidity shortage and contribution to the control of the monetary expansion. The ECB states that the reserve requirement of each institution is determined in relation to elements of its balance sheet. In order to pursue the aim of stabilising interest rates, the Eurosystem's minimum reserve system enables institutions to make use of averaging provisions.

As it has been already mentioned, the main objective of the European Central Bank is the price stability which, by the definition of the ECB means that the annual price should not increase more than 2% (according to the harmonised consumer price index) for the euro area (Issing 2001, p. 70). In addition to the quantitative determination of the ECB objective – price stability, a bank strategy is also pointed out, which consists of two main elements. The first element is money that plays a significant role in determining the quantitative value of the growth of monetary aggregates. Moreover, parallel with the analysis of monetary growth, the analysis of price changes and risks plays main role in the broad assessment of the prospects of the price stability in the euro area, which is the second element of the strategy (Buti 1998, p. 49).

Conclusions

Thus, we can see that the Federal Republic of Germany has played an active role in the formation of the European policy and the European monetary policy in particular. German Bundesbank was actively involved in the creation process of the European Central Bank, bequeathing its primary goal – money stability. Germans had a full confidence in their central bank, sometimes even more than in the government.

However, as Dyson and Marcussen relevantly note, there are two sides of the coin from Germany's entry into the EMU. On the one hand, the EMU empowers central banks to ensure economic stability on the EU level through the ordoliberal paradigm of sustainable policy, held by the Bundesbank. On the other hand, the EMU disabled the Bundesbank to act on the domestic, EU and international levels (Dyson, Marcussen 2010, p. 135). Comparing to the U.S. Federal Reserve or the Bank of England, Bundesbank has lost its position in the IMF or G7 and focused its work exclusively to pursue the common interests of the Eurogroup and ECOFIN.

The drawback in creating the German model for the ECB was that it picked up only some isolated pieces of "German organised capitalism". Thus, the ECB does not include such elements as: the legal basis for regulation of industrial relations, involvement of banks and employees into the decision-making process (corporate governance), the system of collective bargaining based on the social partnership,

a dual system of vocational education and training which all together are the integral parts of the Rhine capitalism or coordinated market economy. Perhaps this drawback can somehow explain the inability of Greece and other European countries to cope with the crisis in the German way. Yet, the positive results can only be achieved when all elements of the system interact.

It is hard not to mention that the role of the Bundesbank increased again in the time of recent economic crisis. It was much more influential than one would think. The Bundesbank President Jens Widmann warned the ECB about its possible loss of the reputation. The Bundesbank also thinks about what will happen if the Eurozone breaks apart. In this case, its role and position with no doubt would only intensify. Widmann like all other central bank presidents of the euro area has only one vote in the board of the ECB, although its share in the assets of the ECB is much higher. But he tries to raises his influence as all Bundesbank ex-presidents did – by appealing to public opinion in Germany and asking inconvenient questions about political solutions. If the German Chancellor Angela Merkel “has understood that the ECB might be useful” and has spoken more often with the approval in favour of its activities lately, her former adviser Jens Widmann has a different opinion. The Bundesbank President is trying to consolidate banks’ independence from Merkel and to gain a reputation of a true leader of the Bundesbank. That is why modern European politicians, like their predecessors, have to vex their minds with the next step of the Bundesbank in pursuing the glory of “safe money”.

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Summary

This paper presents the analysis of German monetary policy and its influence on the formation of the European Union monetary policy from the historical point of view. Germany's monetary policy with its independent Bundesbank was quite successful since the 1950s. Strong *Deutsche Mark* has become one of the main currencies in Europe and particularly in the European Community. Other weaker European currencies had to tie their own currencies the German mark. In the negotiation process on the monetary union, Germany took very active part and was a leader in creating European currency; that is why the European Central Bank has acquired the main features of the German Bundesbank.

Key words: monetary policy, EU, Germany, Bundesbank.

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