Central Bank Independence - an Option for Britain?

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The aim of this paper is to give an explanation for the evident problems the United Kingdom is experiencing with the European Monetary Union and the European System of Central Banks as planned by the Maastricht Treaty and with the concept of central bank independence in general. After tracing back these difficulties to special traditions of British constitutional thought, a model is presented that is capable of overcoming the aforementioned tensions and retains the functional advantages of central bank independence while at the same time taking account of central premises of British constitutional thought.

The Maastricht Treaty and the Issue of Central Bank Independence

The Maastricht Treaty and its protocols are a new step in European political integration.[1] They include, among other things, the establishment of an Economic and Monetary Union as well as the creation of a European System of Central Banks responsible for the conduct of monetary policy. Although not in force until November 1993 (because of several delays in Denmark and the United Kingdom as well as action before the German Federal Constitutional Court), the Maastricht Treaty has already had substantial institutional consequences in several member countries of the EC. The Federal Republic of Germany,

1 The treaty and the protocols can be found in: Bundeszentrale für politische Bildung (ed.), *Europäische Gemeinschaft. Europäische Union*. Die Vertragstexte von Maastricht, Bonn 1992. References in this paper are to this edition, which incorporates the changes introduced by the Treaty on European Union.

for example, has modified its Basic Law to set up a Bundestag Committee for European Affairs with far-reaching powers and has extended Article 88 to allow the transfer of the tasks of the Bundesbank to a future European Central Bank. Several other countries have already taken steps to grant independence to their central banks, although this is only required by the treaty after the start of the second stage of Economic and Monetary Union, i.e. after January, 1994. Some examples may serve to illustrate this trend.

As early as the 1993 French election campaign, there was agreement between the Socialists and the Conservative parties to give independence to the Banque de France after the election (*The Economist*, 16.1.1993). After the victory of the conservative parties, Prime Minister Balladur announced a bill to completely alter the organization as well as the task of the Banque de France ("to conduct in full independence monetary policy with the aim of securing price stability"). In the meantime, this bill has been passed by the Council of Ministers. The Belgian government has also secured the independence of the Belgian central bank and has changed the institutional setup of the bank accordingly. The financing of state deficits is explicitly forbidden, and the right of the finance minister to veto central bank policy decisions has been abolished.[2] The Spanish central bank is also to achieve independence from government sooner than the Maastricht Treaty requires. Again the preservation of price stability is to be the main aim, and the institutional framework will be altered to secure more independence (with respect appointment, procedures and terms of office).[3] Portugal and Italy are two other countries that in recent years have changed the constitutional position of their central banks allowing them more independence.[4]

Many of the reforms mentioned above as well as the construction of the European System of Central Banks (ESCB) mimic organisational features of the central bank generally regarded to be the most independent from its government, viz. the Bundesbank (see Caesar

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2 *Börsenzeitung*, 17.3.1993, quoted from Deutsche Bundesbank, *Auszüge aus Presseartikeln*, 21/1993: 14 (hereafter quoted as PA), and *Frankfurter Allgemeine Zeitung (FAZ)*, 22.4.1993: 13.

3 *Financial Times*, 30.12.1992, quoted from PA 1/1993: 10. See also "Proyecto de ley de autonomía del Banco de Espana", in: Cinco Días, Suplemento Especial, January 5 and 6, 1993.

4 Cf. *Financial Times*, 6.1.1993 and *Handelsblatt*, 6.1.1993, both quoted from *PA* 2/1993: 4,5 and *Handelsblatt*, 16./17.4.1993, quoted from PA 28/1993: 9.

1981, Woolley 1985, Alesina 1989, Busch 1993). By this process of diffusion, something is being created that could be called the *Continental European model of central bank independence*.

Both the Bundesbank and the ESCB have a two-tier structure in their policy-making body, the Central Bank Council: a directorate (which manages day-to-day affairs) and a council with one representative from each of the central banks that make up the whole system (in Germany from the *Länder* Central Banks, in Europe from each of the EC countries).[5] In both models the members of the directorate are selected by the government (the Federal Government in the German and the Council of Ministers in the European case) and appointed by the Federal President and the European Council, respectively. Their periods of office last eight years, and within the ESCB reappointment is not possible, which means greater independence than in the Bundesbank model. Dismissal is possible in both models but not for political reasons. The independence of both the Bundesbank and the ESCB are legally guaranteed, with the maintenance of price stability set as their main task.[6] Both are therefore remote from the government and consciously removed from direct influence of the democratic decision-making process.

The United Kingdom is not taking part in the developments described above. Next to Denmark, it is the only EC country to have secured for itself an opting-out clause for stage three of the Economic and Monetary Union (EMU).[7] A further example of the United Kingdom distancing itself from the idea of EMU can be seen in its rejecting the option for re-entry into the exchange rate mechanism of the EMS for the life of the current Parliament, as the Major government did after the United Kingdom was forced to leave the exchange rate mechanism in the autumn of 1992 (whereas Italy, which was also forced out of the exchange rate mechanism, has confirmed its intention of re-entering as soon as possible). In addition, the United Kingdom is making no moves to grant independence to its central bank, as prescribed for stage two of EMU. Even more, on the occasion of

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5 Cf. Deutsche Bundesbank 1993 and "Protokoll über die Satzung des Europäischen Systems der Zentralbanken und der Europäischen Zentralbank" in: *Bundeszentrale für politische Bildung* 1992: 190ff.

6 Cf. §§ 3 and 12 of the Bundesbank Act and article 105 and 107 of the EEC treaty.

7 Cf. the "Protokoll über einige Regelungen betreffend das Vereinigte Königreich von Großbritannien und Nordirland" in: *Bundeszentrale für politische Bildung* 1992: 233ff.

announcing the appointment of the next Governor of the Bank of England, Prime Minister John Major reaffirmed that the British government remained opposed to the idea of an independent central bank.[8]

A critical assessment of independent central banks is quite common in Britain, as became evident in the wake of the EMS-crisis of autumn 1992. In public and political debate it is often argued that something as essential as monetary policy should not be left to "unelected bankers", but to a democratically legitimized government. This view follows from the tradition of British monetary policy, for which it is not the Bank of England that is responsible, but ultimately the Chancellor of the Exchequer (Busch 1989: 67). The Bank of England is therefore, especially in international comparison, ranked as highly dependent on the government (Alesina 1989). To demonstrate the direct impact of the Treasury upon all decisions of the British central bank, one can turn to the famous quote of the former Chancellor of the Exchequer, Sir Stafford Cripps: "The Bank is my creature."

The Advantages of Central Bank Independence in Theoretical and Empirical Perspective

At this point the question arises why central bank independence matters and what the advantages of an independent central bank are. From a theoretical perspective an independent central bank is supposed to be a means to achieve as high a degree of price stability as possible, i.e. low inflation. This is to be brought about by removing the power over monetary policy decisions (which are seen to be the main cause for inflation) from the government, as politicians could misuse it for their own ends and thereby cause higher inflation than would otherwise be the case. This is because it can be interesting for them to ignore the undisputed long-term advantages of price stability for other short-term advantages.

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8 *The Times*, 23.1.1993, quoted from PA 6/1993: 14. But the article also mentions that the City increasingly favours an independent central bank.

According to this perspective, the expectations of economic actors are strongly influenced by politicians' announcements.[9] To keep inflationary expectations (which are known to be an important determinant of inflation) low, politicians promise not to lower unemployment below the "natural rate" (which would induce an acceleration on inflation).[10] On the other hand, politicians might be interested in not keeping that promise (because "cheating" is difficult to monitor for the public) and thereby reap the benefits of short-run higher growth (such as e.g. a lower rate of unemployment).[11] It is evident that such a behaviour is attractive to politicians mainly with regard to elections (theory of political business cycles). Only worth mentioning in passing is the discussion as to whether different political parties prefer different macroeconomic configurations and therefore different rates of inflation (Hibbs 1977).

Alesina (1988: 40) gives three aims that can be achieved through an independent central bank:

1. a reduction of the general inflationary tendency resulting from political manipulation of monetary policy;
2. a reduction of changes in monetary policy resulting from general elections and appointment of political office-holders;
3. a reduction of pre-electoral manipulation of monetary policy.

For politicians ceding responsibility for monetary policy to an independent central bank therefore amounts to a voluntary "tying of their hands" that is intended to enhance the credibility of target-figure announcements. This not only serves to improve macroeconomic efficiency, but can also have clear fiscal effects, e.g. because the markets no longer demand higher rates of interest as a risk premium because they expect the rate of inflation to be higher than announced. Therefore a lowering of the level of interest rates becomes possible,

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9 See Woolley 1992 and, especially for the theory of political business cycles, Alesina 1989.

10 For the concept of the "Non-Accelerating Inflation Rate of Unemployment" see e.g. Samuelson/Nordhaus 1987, vol. 1: 347-355.

11 This perspective is compatible with economic models based on the theory of rational expectations, which deny an exploitable trade-off between inflation and unemployment (the so-called "Phillips-Curve"), but admit the existence of "surprise" effects.

with positive effects on investment and economic growth. Such risk premiums were no problem in the relatively closed financial markets of previous decades, but increasing internationalisation and interconnection of the financial markets since the 1970s have changed that: Countries whose fiscal policies are judged to be imprudent have to accept an interest rate premium over "first class debtors" or a lowering of their credit rating, both of which mean increased costs.[12]

An additional effect of an independent central bank that is interesting to politicians is their function as a "scapegoat" or as a "lightning rod" (Woolley 1985: 345; Woolley 1992). For the implementation of a restrictive policy can involve political costs such as decreased electoral popularity caused by lower growth and employment (exactly the type of costs which makes an accommodating monetary policy attractive to politicians). An independent central bank can be blamed for these costs. Woolley's (1992: 171) judgement on the EMS is also applicable here: "It is politically useful to have a policy one prefers 'imposed' from somewhere else when it involves short-run costs."

There is empirical support for the hypothesis of an inverse relationship between the degree of central bank independence and the rate of inflation (Alesina 1988, 1989; Busch 1993). In the 18 OECD countries which have been democratically governed since 1945, there is a close relationship of this kind demonstrated by a high coefficient of correlation of - 0,80. The data for the countries are displayed in Figure 1. The time period is from 1973 onwards, the year of the breakdown of the Bretton-Woods system, after which a sovereign monetary policy and hence an observable impact of central bank independence became possible (Busch 1993).

Moreover, further studies have demonstrated that lowering inflation through an independent central bank must not be paid for with poorer performance of other macroeconomic parameters: For instance, there is no systematic relationship between inflation and unemployment.[13]

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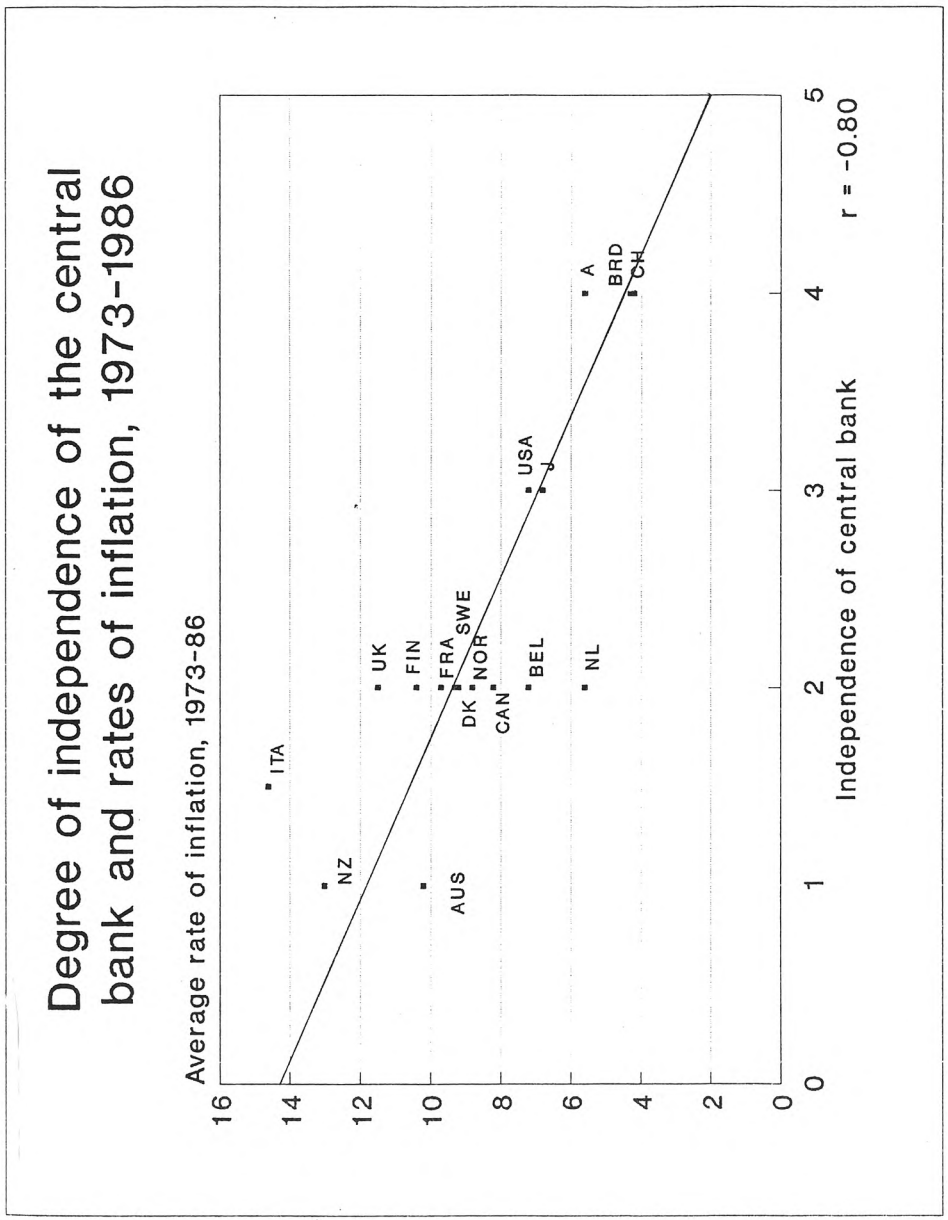
12 As an example see the recent lowering of the credit rating for Italian government bonds by the rating agency Moody's (*Neue Züricher Zeitung*, 7.5.1993: 14).

13 Cf. the results of a study by Alesina and Summers from Harvard University in: "Central banks: America vs. Japan: The rewards of independence", in: *The Economist*, 25. January 1992, 21ff.


Degree of independence of the central bank and rates of inflation, 1973-1986
Average rate of inflation, 1973-86
16
14
12
10
8
6
4
2
0
0
1
2
3
4
5
Independence of central bank
r = -0.80
ITA
NZ
AUS
UK
FIN
FRA
SWE
DK
NOR
CAN
BEL
NL
USA
J
A
BRD
CH

Thus it is clear that an independent central bank is capable of improving the macroeconomic profile of a country to a considerable degree. This effect becomes stronger, the more central bank independence becomes the "standard" among industrial countries - because then the costs for countries that lack this characteristic increase.

Central Bank Independence and the Logic of British Constitutional Thought

The British economy has historically been very inflation-prone. The rate of inflation, in terms of the consumer price index, reached a record of 24.2% in 1975 and of 18.0% in 1980. Both values are substantially above the OECD average. If one compares the 18 OECD countries' rates of inflation between 1965 and 1988, the United Kingdom scores very badly. With an average annual rate of inflation of 8.9% it ranks 15th. Only Ireland, Italy and New Zealand fare worse.[14]

Inflation, therefore, has been a pressing problem in Britain both economically and politically. An independent central bank is primarily a means to lower the rate of inflation. Not least because of the high inflation of the 1970s, Margaret Thatcher, an adherent of monetarism, won the 1979 general election. One could have expected a government such as hers, which broke with so many traditions, also to make the central bank independent. But in spite of the fact that central bank independence is basic to monetarism, no serious attempts have been made since 1979 to grant more independence to the Bank of England. One initiative by former Chancellor of the Exchequer Nigel Lawson was rejected by the Prime Minister and only revealed in his resignation speech in the House of Commons on October 31, 1989 (Busch 1990: 139).

One can certainly say that delegating monetary policy to an independent central bank would have restricted the British government's room to manoeuvre in such a way that Margaret Thatcher, in spite of all her market rhetoric, was not prepared to take that step. But in trying to explain this only in terms of the well-known fact of her fascination with power one runs the danger of overlooking the fact that there are some central characteristics of

14 For more detailed data and results see Busch 1993: 37ff.

British constitutional thought that render the establishment of an independent central bank along German lines practically impossible.

Centralisation

A high degree of centralisation and concentration of power are a constituting characteristic of the British system of government. Arend Lijphart (1984: 8) characterizes the Westminster model (cf. also Punnett 1987: 179):

Local governments in Britain perform a series of important functions, but they are the creatures of the central government and their powers are not constitutionally guaranteed (as in a federal system). Moreover, they are financially dependent on the central government. This unitary and centralized system means that there are no clearly designated geographical and functional areas from which the parliamentary majority and the cabinet are barred.

Three elements of centralisation come together in the British system and reinforce each other:

1. The *territorial* organization of the state is marked by the complete absence of federal elements. Since the Union of the Scottish and the English parliaments in 1707 all power is concentrated in the Parliament of Westminister. In international comparison the degree of centralisation is judged to be very high, as the Royal Commission on the Constitution under Lord Kilbrandon concluded in 1973: "The United Kingdom is the largest unitary state in Europe and among the most centralised of the major industrial countries in the world" (quoted from Hesse/Benz 1990: 79).

2. Within the territorially centralized system there has been an additional *institutional* concentration. During the course of the 19th century, the widening of the franchise (especially after the Reform Act of 1867) and the emergence of a party system induced a power shift from Parliament to the Ministers, i.e. to the Cabinet (Norton 1991: 50f.; Lijphart 1984: 6f.). Within the Cabinet a concentration of power in the hands of the Prime Minister emerged over time. The flexibility and informality of all rules of conduct concerning the business of cabinet have played an important role here and allowed a power-conscious Prime Minister a practically unlimited degree of dominance (Norton 1991: 20ff., 227f.). Especially the Thatcher years have reminded one time and again of Lord Hailsham's

famous characterization of the British system as an "elective dictatorship". A Prime Minister determined to concentrate power in his or her hands meets very few institutionalized barriers in the British system.

3. With respect to party politics, one can speak of concentration of *political* power. This is because normally government is in the hands of *one* party which does not have to deal with institutionalized countervailing powers and does not have to respect the interests of a coalition partner. It is therefore in a position where it can very widely implement its planned policies.

Especially the Thatcher governments tried to do this with all force, which led to a continuing extension of the powers of the central state in order to overcome the resistance of local administrations (Norton 1991: 62f.; Hesse/Benz 1990: 138f.). Thus there was increasing control of local policies by the central administration during this period. It was not based on mutuality between the different layers, but was clearly instituted from above. This is demonstrated, for example, in the increasing share of central state financial grants to the lower strata of government, which have to a large degree replaced local governments' own sources of revenue (Hesse/Benz 1990: 79-86).

The high degree of centralization has often been blamed for the various symptoms of crisis (Norton 1991: 62f.). As a result of rising demands, e.g. through the build-up of the welfare state, the state is seen as having a problem of "overload". Here the very continuity of the British system turns into a curse, as it has never been forced to undergo a fundamental reform, which would have offered the chance to adapt to new demands. For its implementation government policy is to an ever-increasing degree dependent for its implementation on the agreement of societal groups, since its ability to control them through hierarchical patterns is shrinking (Scharpf 1992). But the institutional logic of the British system is directed more towards a strategy of power than one of consensus (Hesse/Benz 1990: 125f.). Thus it is hardly a paradox that, since 1979, the very Conservative governments that started out to "roll back the frontiers of the state" in fact increased centralization.

To sum up this point, one can say that within the highly concentrated British system of government there is no place for relevant and autonomous actors *outside* the central government.

Accountability to Parliament and Sovereignty of Parliament

Another fundamental proposition of the British Constitution is the accountability of government to Parliament, i.e. the collective responsibility of Cabinet and the individual responsibility of each minister for his or her portfolio. It follows from this that all government action must take place within the hierarchy of one of the departments and that each minister is responsible to Parliament for all actions and non-actions; at all times every single minister and the Cabinet as a whole must have the support of the majority of the House of Commons (Punnett 1987: 198f.; Norton 1991: 211f.).

Both principles can be derived from the one principle that is at the core of the British constitution: parliamentary sovereignty. This means, according to Dicey's (1931: 37f.) famous definition:

The principle of Parliamentary Sovereignty means neither more nor less than this, namely, that Parliament has, under the English constitution, the right to make or unmake any law whatever; and, further, that no person or body is recognised by the law of England as having a right to override or set aside the legislation of Parliament.

Parliament is therefore the focus of Britain's political power structure. There is no legitimate power not derived from it. But at the same time no Parliament is capable of binding its successors, for then these would be less sovereign. Therefore every decision (which includes every ceding of power e.g. to local government institutions) is in principle reversible.

This principle of parliamentary sovereignty is unique in Europe. In most other countries either the principle of popular sovereignty prevails (as in Germany's Basic Law in article 20, 2) or there is no explicit formulation (Gabriel 1992: 454f.). Although not codified, Parliamentary Sovereignty is considered to be "the ultimate political fact upon which the whole system of legislation hangs. ... It may indeed be called the one fundamental law of the British Constitution." (Norton 1991: 79). It follows that every political action or

decision can be reversed by Parliament, and this is incompatible with the principle of an independent central bank.

Countries with independent central banks typically have a *substantially different* institutional framework. There are at least two features which distinguish the Federal Republic of Germany, Switzerland, Austria, the United States and Japan from the British system.

1. Four out of the five are *federal systems*, and Japan is, among the unitary states (next to Sweden), the most decentralized (Lijphart 1984: 178). This does not only include fiscal features as in federal systems; decisions are also decentralized. Besides decentralization there are also, especially in the three European states, mechanisms of collective decision-making which compensate for decentralization and fragmentation and put a premium on consensus .
2. *Significant political actors beyond central government* are another common feature of these states. These include not only the above-mentioned federal institutions, but also institutions such as constitutional courts or truly independent central banks.

We can conclude from this that these countries are prepared, much more than the United Kingdom, for *policy as a result of bargaining between several actors* and that they are used to removing certain decisions from the direct influence of the democratically legitimated parliament. They can be said to have created partial "contre-gouvernements" (Wildenmann 1969: 10), and both stability and success in measures of (economic) policy output justify these decisions.

A Central Bank Model for Britain

The question arises whether the British system is on principle incompatible with the concept of central bank independence, which seems so attractive for reasons of European integration and the above-mentioned economic advantages, or whether one can produce a model which combines the functional advantages of central bank independence with the requirements of the British constitutional system. Such a model would have to have a greater degree of attachment to the processes of the formulation of political demands and objectives and to

democratic legitimization than the *Continental European* independent central banks modelled after the Bundesbank.

It is a feature of the Continental European model of central bank independence that no influence on, or control over, decisions of the bank are possible.[15] Therefore, one cannot be certain that a specific central bank policy meets the preferences of society. The method by which a central bank chooses the inflation target it tries to realize is unknown. Its level cannot be influenced from outside the central bank, and the central bank is not accountable to anybody with respect to its monetary policy. Moreover, for this target choice there is *no best rule* to which the central bank could adhere. On the contrary, the choice of such a target is always a value-based decision (Alesina 1989: 83). And within the Continental European model one cannot make sure that there are no long-term aberrations between society's preferences and those of the central bank. This can easily be attacked from a perspective of democratic theory by referring to the postulate that within a democratic state any institution executing functions of governance is only acceptable if it is subordinated to a politically legitimized body (Caesar 1980: 361ff.). Besides this one can also prefer a basic external controllability of the central bank on the grounds of economic policy coordination. Uncoordinated, fiscal and monetary policy are very unlikely to have an optimal effect .

A solution to the problem presented here would be a central bank constitution consisting of the following two elements:

1. a publicised treaty between the administration and the central bank announcing a medium-range inflation target (over a period of say two to three years) and
2. a central bank that is obliged to meet that target and has complete operational independence for all measures required to do so.

Such a model of central bank independence has several advantages over the Continental European model without having relevant disadvantages:

- Accountability to the democratically legitimized parliament is preserved.

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15 Short of changing or abolishing its legal foundations, which seems to be quite a high hurdle.

- The general (i.e. medium and long-term) correspondence between the aims of the central bank and those of parliament (and society) is ensured; the central bank therefore has a high level of legitimacy for carrying out the measures necessary for reaching the target. At the same time short-term manipulations of monetary policy, e.g. for electoral reasons, are ruled out.
- Adjusting the inflation target in the case of unforeseeable developments or external shocks (e.g. an oil price shock) would be possible, but would have to be done publicly as well.
- Announcing all target choices in public would strongly influence inflationary expectations, which are themselves an important determinant of inflation.
- Public aversion to inflation and pressure from international financial markets would assure the choice of as low an inflation rate as possible.

Some experiences with a model of central bank independence similar to that sketched out above have been made in New Zealand in the last couple of years. New Zealand's constitutional system is very similar to the British system. In the light of the challenges the British system has faced in recent years, New Zealand has become more akin to the ideal type of the "Westminster Model" than Britain herself, as Arend Lijphart (1984: 19) writes: "In nearly all respects, democracy in New Zealand is more clearly majoritarian, and hence a better example of the Westminster Model, than British democracy." For the purpose of this paper it is especially relevant to highlight the fact that the principles of centralization and parliamentary sovereignty also apply.

For a long time, New Zealand was a country with a very low degree of central bank independence (see the above categorization in Figure 1), and an extremely bad inflation profile. In the time period 1965-1988, New Zealand had an average annual rate of inflation of 10.4% and thus came last among the 18 democratic OECD countries (Busch 1993).

In 1989, the *Reserve Bank Act* was passed, giving a new foundation to monetary policy (Swinburne and Castello-Branco 1991, Pringle 1991, and OECD 1993). Monetary policy was assigned the primary aim of maintaining price stability. This aim, however, was not operationalized, but depends on a so-called "Policy Target Agreement" to be negotiated between the Governor of the central bank and the Finance Minister, setting out the rate of inflation to be reached by the central bank over a certain period of time. If the central bank

misses that target without an extraordinary external cause, the Governor of the central bank loses his job. The "Policy Target Agreement" is public. The administration has the right to override the set target for up to twelve months and also the right to demand negotiation of a new inflation target. But both things have to happen in public. The main aim of this settlement was to give independence to the central bank in terms of the operation of monetary policy while at the same time assuring accountability for reaching the target and maintaining transparency for the public (OECD 1993: 46). The current "Policy Target Agreement" aims at a rate of inflation between 0 and 2% for December 1993.

We can conclude from the data available that the reform of New Zealand's central bank constitution has delivered the expected positive results: in 1987 the rate of inflation was 15.7% and in 1989, the year of the reform, it was 5.7%; in 1991 it reached a remarkable 2.6% and in 1992 a mere 0.9%. Although the whole story is probably more complex and although these developments may not only be attributable to the central bank, these results indicate a success for New Zealand's monetary policy. In the light of the data given, it seems that the inflation target of 0 - 2% by December 1993 is quite achievable. Besides the marked lowering of the rate of inflation there are additional positive effects, e.g. a lowering of inflationary expectations and a substantial drop in long-term interest rates for government bonds, which amounts to substantial fiscal relief for New Zealand's government (OECD 1993: 47ff.).

Is New Zealand's central bank constitution transferable to Britain? The British system of government is not very open towards foreign examples of reform - very often the feeling is still dominant that (to quote a backbencher from the year 1981) "our constitution is the envy of the world" (quoted from Norton 1991: 58). Even obvious shortcomings with respect to modernization and policy outcomes have failed to change that assessment substantially. Proposing Continental European or even German examples as a model for reform will not lead very far, judging by experience. But in the case of New Zealand this could be different...

Central Bank Independence - a Guarantee of Low Inflation?

I do not want to suggest that an independent central bank alone as a *Deus Ex Machina* can solve the problem of inflation. Inflation is not a technical problem of control of the money supply, but a societal phenomenon - the expression of distributive struggles. The rate of inflation is therefore influenced by several additional factors, among them the system of collective bargaining and its militancy (influenced by organizational features), but also characteristics of fiscal centralization within a state (Busch 1993, Hall 1993).

Coordinated, relatively highly aggregated systems of collective bargaining and fiscal decentralization such as can primarily be found in federally organized states are not only the attendant circumstances of societies with relatively low inflation. They are characteristics of mechanisms of coordination which facilitate low-conflict solutions of distributive questions within society. It is not by chance that the Bundesbank, in statements about price stability in Europe, often refers to German *Stabilitätskultur*, the "culture of stability". The willingness to solve distributive questions in a non-inflationary way cannot be reached through institutions - or at least not through them alone. A European Central Bank, alone responsible for the maintenance of price stability (without the support of other suitable institutions such as those mentioned above from the fields of fiscal policy and collective bargaining), would only be able to reach its aim at considerable cost in terms of unemployment and reduced growth. This would substantially endanger its legitimacy and the legitimacy of such a policy in general.

Seen from this end one could even attribute a certain logic to the current British position: with its fiscal centralism and its conflict-ridden industrial relations, an independent central bank vigorously pursuing the aim of price stability would probably cause such high costs. Several attempts at reform have failed here in the past. But can this be a reason to give up all attempts at reform in the future? That would amount to a voluntary resignation on the part of the political system.

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