

Central Bank Independence and the Westminster Model

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The article deals with and traces the current emergence of a 'Continental European' model of central bank independence in several European countries as well as in the Maastricht Treaty (modelled along the lines of the Bundesbank's constitution) and juxtaposes this with outright rejection of central bank independence in the UK. It is then asked why this is the case, the answer being provided by particular British constitutional traditions, most notably the doctrine of parliamentary sovereignty. This is followed by the presentation of a model of central bank independence compatible with the requirements of British constitutional thought while still capable of providing the advantages of removing day-to-day monetary policy from the hands of the administration. Experiences from New Zealand with a similar model and an outlook on the consequences of recent turbulences in the EMS conclude the article.

The purpose of this article is to try to give an explanation for the evident problems the United Kingdom is experiencing with European Monetary Union and the European System of Central Banks as planned by the Maastricht Treaty in general and with the concept of central bank independence in particular. 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 PRESENT SITUATION

The Maastricht Treaty and Changes in the Constitutional Position of European Central Banks

The Maastricht treaty and its protocols lift European political integration to a new stage.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 1 November 1993, because of several delays (in Denmark, the United Kingdom and 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 has, for example, amended its Basic Law to set up a Europe Committee in the Bundestag with far-reaching powers and has amended Article 88 to allow the transfer of the tasks of the Bundesbank to a future European Central Bank.² 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, that is, after January 1994. Some examples may serve to illustrate this trend.³

France. As early as the 1993 election campaign there was agreement between the Socialists and the bourgeois parties to give independence to the Banque de France after the election. After the victory of the bourgeois parties Prime Minister Edouard Balladur announced a bill to completely alter the organisation as well as the task of the Banque de France ('to conduct in full independence monetary policy with the aim of securing price stability'). This bill has in the meantime been passed by the Council of Ministers.

Belgium. The Belgian government has also secured the independence of the Belgian central bank through law and has changed the institutional set-up of the bank accordingly. The financing of state deficits is explicitly forbidden and the right of the finance minister to veto monetary policy decisions has been abolished.

Spain. 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 to mechanisms of appointment or terms of office). Portugal and Italy are two other countries that in recent years have changed the constitutional position of their central banks towards acquiring more independence.

Organisational Features of the Bundesbank and the European System of Central Banks: the Continental European Model

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, namely the Bundesbank.⁴ By this process of diffusion something is being created that could be called the *continental European model of central bank independence*. Its main features are briefly highlighted below through a comparison of the Bundesbank and the ESCB. Both the Bundesbank and the ESCB have in their policy-making body, the Central Bank Council, a two-tier structure, comprising a directorate (which manages day-to-day affairs) and one representative each of the central banks that make up the whole system (i.e., the *Länder*⁵ and the EC countries, respectively).⁶ The members of the directorate in both models 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 is supposed to lead to enhanced independence over the Bundesbank model. Removal is in both models only possible for cause, but not for political reasons.

Both the Bundesbank and the ESCB have their independence legally guaranteed and have the maintenance of price stability set as their main tasks.⁷ Both are therefore remote from the government and consciously removed from direct influence of the formulation of political demands and objectives.

This very brief overview shows the great similarities in the institutional setup of the two central banks and makes it clear that the ESCB was modelled along the lines of the Bundesbank.

The Special Position of the United Kingdom

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 Economic and Monetary Union (EMU).⁸ A further example of the United Kingdom distancing itself from the idea of EMU can be seen in its excluding 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 September 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. Quite the contrary, on the occasion of 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.⁹

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 criticisms are often voiced that something as essential as monetary policy should not be left to 'unelected bankers', but only to a democratically legitimised 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.¹⁰ The Bank of England is therefore, especially in international comparison, ranked as highly dependent on government.¹¹ To demonstrate the direct impact of the Treasury upon all decisions of the British central bank, one can quote the former Chancellor of the Exchequer, Sir Stafford Cripps, who said famously: 'The Bank is my creature.'

THE ADVANTAGES OF CENTRAL BANK INDEPENDENCE IN THEORETICAL AND EMPIRICAL PERSPECTIVE

Central bank independence, as can be seen from the above discussion, is not completely undisputed. At this point the question arises why central bank independence matters and what the advantages of an independent central bank are. These questions will briefly be dealt with in the following section from a theoretical and an empirical point of view.

Theoretical Reasons

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, that is, 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 exploit the undisputed long-term advantages of price stability at the cost of other short-term advantages.

According to this perspective the expectations of private individuals are strongly influenced by politicians' pronouncements.¹² 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 of inflation).¹³ 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., higher employment or a lower rate of unemployment).¹⁴ It is evident that such behaviour is attractive to politicians mainly with regard to elections (Theory of Political Business Cycles). Only in passing would it be mentioned whether different parties prefer different macroeconomic configurations and therefore different rates of inflation.¹⁵

Alesina gives three aims that can be achieved through an independent central bank:

- (1) a reduction of the general *inflation bias* of democratic monetary policy;
- (2) a reduction of partisan variability in monetary policy;
- (3) a reduction of pre-electoral manipulation of monetary policy.¹⁶

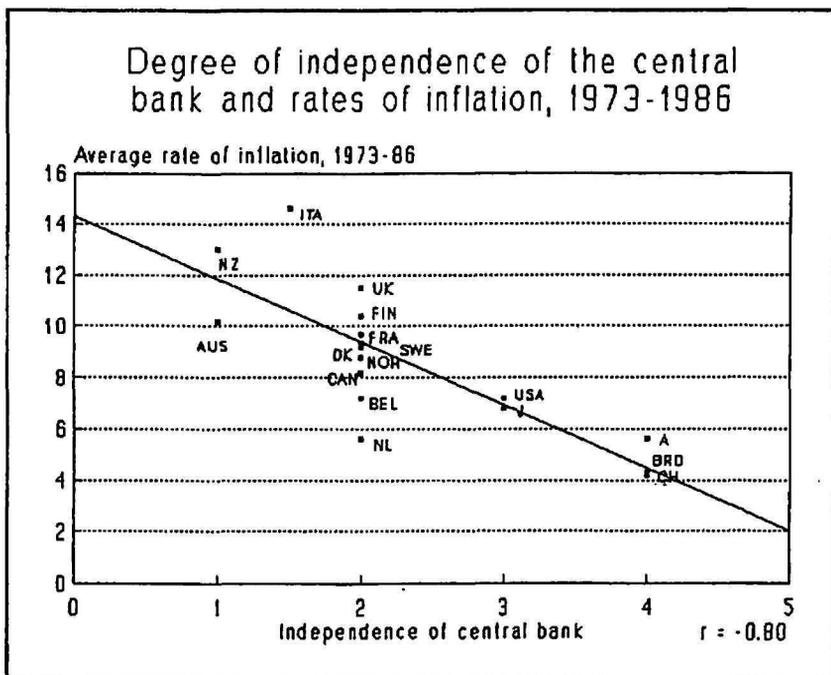
Ceding responsibility for monetary policy to an independent central bank therefore amounts for politicians to a voluntary 'tying of their hands' that is intended to enhance the credibility of target announcements for inflation. This not only serves to improve macroeconomic efficiency, but can also have clear fiscal effects, for example, 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, with positive effects on investment and economic growth. Such risk premiums were no problem with the relatively closed financial markets of previous decades, but increasing internationalisation and interconnection between 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 means increased costs.¹⁷

An additional effect of an independent central bank interesting to politicians is their functioning as a 'scapegoat' or as a 'lightning rod'.¹⁸ 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 judgement on the EMS has an analogy here: '[. . .] it is politically useful to have a policy one prefers "imposed" from somewhere else when it involves short-run costs.'¹⁹

Empirical Results

Several students have tested the hypothesis of an inverse relationship between the degree of central bank independence and the rate of

FIGURE 1
CENTRAL BANK INDEPENDENCE AND THE RATE OF INFLATION IN
18 OECD COUNTRIES, 1973-86



Source: Busch 1993.

inflation and have found empirical support for it.²⁰ If one looks at the 18 OECD countries which have continuously been democratically governed since 1945, there is a close relationship, which is also demonstrated by a high coefficient of correlation amounting to -0.80 . The data for the countries are displayed in Figure 1. The time period is from 1973 onwards, namely, after the breakdown of the Bretton-Woods system, only after which a sovereign monetary policy and hence an effect of central bank independence became possible.²¹

Moreover further studies have demonstrated that lowering inflation through an independent central bank has no negative implications for other macroeconomic parameters such as the rate of unemployment: there is no systematic relationship between the two variables.²²

One can summarise the above in saying that an independent central bank is capable of improving the macroeconomic profile of a country to a considerable degree. This is all the more the case the more central

bank independence becomes the 'standard' among industrial countries – because then the costs for other countries of standing apart increase.

CENTRAL BANK INDEPENDENCE AND THE LOGIC OF BRITISH CONSTITUTIONAL THOUGHT

As has been demonstrated above, an independent central bank is primarily a means to lower the rate of inflation.

The British economy has historically been very inflation-prone. The rate of inflation, measured in the consumer price index, reached a record 24.2 per cent in 1975 and 18.0 per cent 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 per cent it comes 15th in the distribution. Only Ireland, Italy and New Zealand fare worse.²³ Inflation, therefore, has been a pressing problem in Britain, and not only in an economic sense, but also in political terms. 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 that broke with so many traditions also to introduce an independent central bank. Yet in spite of the fact that central bank independence is central to monetarism, no serious attempts have been made since 1979 to grant more independence to the Bank of England. One such attempt 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 31 October 1989.²⁴ History seemed to repeat itself when Norman Lamont, after leaving the Chancellor's office, declared that he, too, had for two years tried to convince the Prime Minister of the benefits of an independent central bank, but to no avail.

One can certainly say that delegating monetary policy to an independent central bank would have restricted the British government's room for manoeuvre in such a way that not even Margaret Thatcher, in spite of all her market rhetoric, was prepared to take that step.

But in trying to explain the absence of a move central to the monetarist policy doctrine only through the well-known consciousness for power (especially of a Conservative government) one runs the danger of overlooking the fact that there are some central characteristics of British constitutional thought that render the establishment of an independent central bank along German lines practically impossible. Such a model would be in conflict with central premises of the British constitution. The two main points of conflict will briefly be described below.

Centralisation

A high degree of centralisation and concentration of power are a constituting characteristic of the British system of government. Arend Lijphart characterises the Westminster model:

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.²⁵

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

1. *Territorial*: the British system is characteristically a unitary system 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 Westminster. Also 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.'²⁶

2. *Institutional*: Within the territorially concentrated system there has been an additional institutional concentration. During the nineteenth 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, that is, the Cabinet.²⁷ Within 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.²⁸ Especially the Thatcher years have reminded one time and again of Lord Hailsham's famous characterisation of the British system as 'elective dictatorship'. A Prime Minister determined to concentrate power in his or her hands meets very few institutionalised barriers in the British system.

3. *Political*: With respect to the political sphere one can also speak of centralisation. That is because normally government is in the hands of

one party, which does not have to deal with institutionalised counter-vailing 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.

The Thatcher governments especially tried this with all force, which led to an ever increasing power of the central state in order to overcome the resistance of local administrations.²⁹ Thus increasing control of local policies through the administration of the central state emerged over time. Yet this was not characterised by interaction between the different layers, but was clearly a hierarchical relationship. 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.³⁰

The high degree of centralisation has often been blamed in the British debate for the various symptoms of crisis.³¹ For in the face of rising demands on it (e.g., through the build-up of the welfare state) the state is seen as having a problem of 'overload', because its capability of solving its tasks shrinks. Here the very continuity of the British system turns into a curse, as it has never been forced to undergo a fundamental reform, which at the same time is the chance to adapt to new demands. Government policy for its implementation nowadays depends to an ever increasing degree on the agreement of societal groups, just as its ability to control through hierarchical coordination shrinks.³² Yet at the same time the institutional logic of the British system is directed more towards a strategy of power than one of consensus for its implementation.³³ Thus it remains a paradox that the very Conservative governments since 1979 that started out to 'roll back the frontiers of the state' increased its centralisation.

To sum it up 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, namely, 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 department, whose minister is responsible before Parliament for all actions and non-actions in his field. Added to that is the principle that the Cabinet as a whole and every single minister must

at all times have the support of the majority of the House of Commons.³⁴

Both principles can be derived from the one principle that is fundamental to the whole British constitution, parliamentary sovereignty. This means, according to Dicey's 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.³⁵

Parliament is therefore the focus of Britain's political power-structure. There is no legitimate power not derived from it. Yet 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, for example, to local government institutions) is in principle reversible.

This principle of parliamentary sovereignty is an exception in Europe. In most other countries the principle of popular sovereignty prevails (as in Germany's Basic Law in Article 20, 2) or there is no explicit formulation.³⁶

The British sovereignty of Parliament can be traced back directly to the year 1688 and the Glorious Revolution, when Parliament installed the King. It is not codified, but one of the many 'constitutional conventions' in Britain. As there is no written constitution,³⁷ there has never been a constituent act which could have placed sovereignty outside Parliament. Although nowhere written down, 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.'³⁸ 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.

The considerable pressure created by the problem of inflation in both economic and political terms, it can be concluded, was evidently not strong enough to overcome the obstacles described in this section.

What are the characteristics of other countries in this field?

Here follows a brief description of countries which have established independent central banks. It will make clear that *substantial differences* exist between them and the United Kingdom with respect to the institutional framework. The countries to be looked at now comprise the Federal Republic of Germany, Switzerland, Austria, the United States

and Japan – countries which can be classified as having an independent central bank.³⁹ They have at least two facts in common which differentiate them from the British system:

1. *Decentralisation* is one of the most prominent features of this group of countries. Four out of the five are *federal systems*, and Japan is, among the unitary states (next to Sweden), the most decentralised one.⁴⁰ This not only includes fiscal features, as in federal systems decisions are also decentralised. Besides the decentralisation there are also, especially among the three European states, mechanisms in place of collective decision-making, which overarch decentralisation and fragmentation and put a premium on consensual decisions.
2. *Significant political actors outside 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 actually independent central banks.

We can conclude from this that the countries under consideration 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 'contra-gouvernements',⁴¹ and both stability and success in measures of (economic) policy output justify these decisions.

A CENTRAL BANK MODEL FOR BRITAIN

Of course, now 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 can one think of 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 an increased degree of attachment to the processes of the formulation of political demands and objectives and to democratic legitimisation over 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.⁴² Therefore one cannot make sure that the target choice of the central bank is the same as, or in any way linked to, the preferences of society. The method by which such a central bank chooses the inflation target it tries to realise is unknown. Its level cannot

be influenced from outside the central bank, and the central bank is not accountable to anybody with respect to economic policy.

Yet for this target choice there is *no best rule* to which the central bank could adhere. On the contrary, choosing such a target is always a decision which is based on values.⁴³ 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 (at least partially) functions of governance is only acceptable if it is subordinated to a politically legitimised body.⁴⁴

Besides this one can also prefer a basic external controllability of the central bank on the grounds of policy-mix. Uncoordinated fiscal and monetary policy are very likely not to hit the potentially optimal mix of the two policies.

A fundamental 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.

Advantages of this Model

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

- Accountability to the democratically legitimised parliament is preserved.
- 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, for instance, 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 and possible changes to them in public would guarantee strong influence on inflationary expectations, which are themselves an important determinant of inflation.

- Public aversion to inflation and pressure from the international financial markets would assure the choice of as low an inflation target as possible.

Experiences from New Zealand

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. Over a long period New Zealand has been a country with, on the one hand, a very low degree of central bank independence (see the above categorisation in Figure 1), on the other hand it had an extremely bad inflation profile. In the time period 1965–88 New Zealand had an average annual rate of inflation of 10.4 per cent and thus came last among the 18 democratic OECD countries.⁴⁵

In 1989 the *Reserve Bank Act* was passed, giving a new foundation to monetary policy.⁴⁶ Monetary policy was assigned the primary aim of maintaining price stability. This aim, however, was not operationalised, 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 should miss that target without extraordinary external shocks justifying this, 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.⁴⁷ The current 'Policy Target Agreement' aims at a rate of inflation between 0 and 2 per cent for December 1993.

Although it is not the main point in this article, it is of course interesting to look at the result of the reform of monetary policy in chronically inflation-prone New Zealand: have there been any noticeable improvements?

In 1987 the rate of inflation was 15.7 per cent, in 1989, the year of the reform, 5.7 per cent. In 1991 it reached a remarkable 2.6 per cent, and in 1992 a mere 0.9 per cent. Although of course the whole story is probably more complex and these developments may not only be attributable to the central bank, this brief overview indicates a success for New Zealand's monetary policy. In the light of the given data, it does not seem improbable that the inflation target of 0–2 per cent will

have been reached by December 1993. Besides the marked lowering of the rate of inflation there are additional positive effects, for example, 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.⁴⁸

We can therefore conclude that there are indications that the reform of New Zealand's central bank constitution has delivered the expected (and strived-for) positive effects.

Now we shall turn to the question of transferability to the British system. The British system of government is not very open towards positive 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'.⁴⁹ Even obvious shortcomings with respect to modernisation and policy outcomes have failed to change that assessment substantially. Proposing Continental European, even German examples as a model for reform will not lead very far, judging by experience. But New Zealand could be different.

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 in the meantime is more akin to the ideal type of the 'Westminster model' than Britain herself, as Arend Lijphart 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.'⁵⁰ For the purpose of this article it is especially relevant to highlight the fact that the principles of centralisation and parliamentary sovereignty also apply. The central bank model could therefore well be applied to the United Kingdom – if there was no problem of ex-colonial pride . . .

CENTRAL BANK INDEPENDENCE – SUFFICIENT FOR LOW INFLATION?

At the end of this article I should briefly like to point out that an independent central bank alone as a *deus ex machina* cannot 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, its militancy (influenced by organisational features), but also characteristics of fiscal centralisation within a state.⁵¹

Co-ordinated, relatively highly aggregated systems of collective bargaining and fiscal decentralisation such as can primarily be found in federally organised 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, when talking 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: here, 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 for reform for the future? That would amount to a voluntary resignation by the political system.

THE RECENT TURBULENCE IN THE EUROPEAN MONETARY SYSTEM

The recent turbulence in the European Monetary System shall be the subject of a brief concluding remark, asking what they mean for the subject discussed in this article. After continuing massive speculative attacks on several currencies in the EMS, most notably the French franc, EC finance ministers on 2 August 1993 decided to widen the obligatory marginal intervention thresholds in the EMS from ± 2.25 per cent to ± 15 per cent around the bilateral central rates, which remained unchanged. They made it clear that this was a temporary measure.⁵² At the same time the German and the Dutch central banks reached a bilateral agreement to keep their currencies' exchange rates within the old 2.25 per cent bands.

Two main causes lie behind the troubles of the EMS. The first is the fact that between spring 1987 and autumn 1992 there were no realignments in the EMS, although economic fundamentals in the member countries, most notably the rates of inflation (although converging) continued to show significant differences. The EMS, after the Single European Act and in the run-up to 1992, prematurely tried to act like a monetary union. The built-up tension resulted in a series of realignments after autumn 1992 and the ejection of two member currencies

from the exchange rate mechanism (ERM). The second reason for the problems is the substantial economic strains arising from German unification, which caused inflationary tendencies in the German economy. This in turn prompted the Bundesbank to pursue a tight monetary policy orientated towards German needs, while the other EMS countries, troubled by recession, demanded low rather than high interest rates.

After the new situation in the EMS, there is now more room for manoeuvre in monetary policy for EMS member states to pursue national priorities. Yet the question is to what extent they will make use of it. Contrary to the United Kingdom, which after leaving the ERM in September 1992 'went for growth' and slashed interest rates, no immediate massive steps in that direction were taken by any of the EMS countries. In the conduct of their currency policies European governments now face two competing logics that can influence their behaviour:

On the one hand, there is the *logic of economic integration*. Highly integrated economies in the EC, and not least of all the Common Agricultural Policy, have been forceful promoters of currency cooperation in the EC since the end of the Bretton Woods system in the early 1970s. Limiting exchange rate fluctuations and thus creating stability for trade has been in the interest of all countries. This would suggest a continuation of co-operation which might ultimately lead back to narrower margins in the EMS and the unaltered pursuit of the timetable towards European Monetary Union. Yet if this was the dominant strategy, there might be incentives for some countries to try to 'free ride' and gain unilateral advantages by loosening monetary policy which would result in a devaluation of their currency and an improvement of their competitive position in the European market.

This *logic of electoral competition* may become dominant in countries where governments face strong pressures from industry and interest groups to switch to an expansionary policy, as was the case in several countries immediately after the change in the EMS. The French government, for example, came under pressure from parts of the Rassemblement Pour La République Party to relax policy and boost output and employment. The higher the costs of the recession in terms of unemployment in a country are and the nearer an election, the stronger these pressures will make themselves felt.

Which of these two logics will dominate in the individual countries and the EC as a whole remains to be seen. There is undoubtedly a considerable potential for policy divergence and for temptations in the direction of competitive devaluations and perhaps even protectionism.

If, for example, there were to emerge a 'hard currency block' with narrow bands (beyond the bilateral Dutch-German agreement), this would clearly jeopardise the core of the Maastricht Treaty, European Monetary Union.

Yet it is also clear that the progress of European integration has been so central to the policies of most European governments in recent years that this process falling apart would imply high political costs for all of them. So it was, for example, considered politically unacceptable to suspend the EMS altogether (as had been proposed by a member country). The impending start of phase two of EMU on 1 January 1994 was a powerful incentive for damage limitation.

After all, the EMS has been a successful system that helped to reduce inflation rates in Europe and to promote policy convergence. For a long time it worked as a mechanism for member countries to import *anti-inflationary credibility* from the independent Bundesbank by voluntarily ceding monetary sovereignty and accepting the anchor role of the German Mark. Through the trend towards independence of the national central banks outlined at the beginning of this article and through the loosening of the discipline imposed by the EMS it becomes now possible (and necessary) for the European countries to build up their own credibility in that field – unless they want to change their course substantially.

However, this does not look very likely at the time of writing. The French government, faced with the declaration of parts of its central bank reform as unconstitutional (because the Maastricht Treaty had not yet entered into force), declared that it would immediately reintroduce the legislation once this precondition is fulfilled, probably in autumn 1993.⁵³

Central bank independence on a national level, it can be concluded, has become even more important through the developments in the EMS. The more it becomes a standard in other European countries, the more the pressure will grow on the United Kingdom to take steps in that direction too.

NOTES

This article is an enlarged revised version of a paper given by the author at the annual conference of the German Association For the Study of British Politics and History. The paper is to be published in *British Politics and the Constitution*, the conference proceedings, which are to appear in mid-1994 in 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: Bundeszentrale für Politische Bildung, 1992). Here the European treaties are used according to this edition which incorporates the changes introduced by the Treaty on European Union.
2. Cf. *Süddeutsche Zeitung*, 5/6 Dec. 1992, p.9.
 3. For the following see on France: *The Economist*, 16 Jan. 1993; *Frankfurter Allgemeine Zeitung*, 22 April 1993, p.13; 12 May 1993, p.15; on Belgium: *Börsenzeitung*, 17 March 1993, quoted after Deutsche Bundesbank. Auszüge aus Presseartikeln, 21/1993, p.14 (hereafter quoted as PA), and *Frankfurter Allgemeine Zeitung*, 22 April 1993, p.13; on Spain: *Financial Times*, 30 Dec. 1992, quoted after PA 1/1993, p.10. See also 'Proyecto de ley de autonomía del Banco de España', printed in *Cinco Días*, Suplemento Especial, 5 and 6 Jan. 1993; on Portugal and Italy: *Financial Times*, 6 Jan. 1993 and *Handelsblatt*, 6 Jan. 1993, both quoted after PA 2/1993, pp.4, 5 and *Handelsblatt*, 16/17 April 1993, quoted after PA 28/1993, p.9.
 4. E.g., Rolf Caesar, *Der Handlungsspielraum von Notenbanken. Theoretische Analyse und internationaler Vergleich* [= Schriften zur Monetären Ökonomie Bd. 13], (Baden-Baden: Nomos, 1981); John T. Woolley, 'Central Banks and Inflation', in: Leon N. Lindberg, Charles S. Maier (eds.) *The Politics of Inflation and Economic Stagnation. Theoretical Approaches and International Case Studies* (Washington: Brookings Instn., 1985); Alberto Alesina, 'Politics and business cycles in industrial democracies', *Economic Policy*, 8 (April 1989), p.55-98; Andreas Busch, 'The Politics of Price Stability: Why the German-Speaking Nations are Different', in Francis G. Castles (ed.) *Families of Nations. Patterns of Public Policy in Western Democracies*. (Aldershot: Dartmouth, 1993), pp.35-91.
 5. After the reform which followed unification and led to a restructuring of the Bundesbank, no longer does each of the 16 *Länder* have its own central bank. There are now only nine *Landeszentralbanken*, which all send their Presidents to the Bundesbank Council. The nine *Länder* central banks are (cf. Deutsche Bundesbank, *Die Deutsche Bundesbank. Geldpolitische Aufgaben und Instrumente* [= Sonderdrucke der Deutschen Bundesbank No. 71] (Frankfurt/Main: Deutsche Bundesbank, 1993, 6. ed): one for Baden-Württemberg, one for Bavaria, one for Berlin and Brandenburg, one for Bremen, Lower Saxony and Saxony-Anhalt, one for Hamburg, Mecklenburg-Westpomerania and Schleswig-Holstein, one for Hesse, one for North Rhine-Westphalia, one for Rhineland-Palatinate and the Saarland and lastly one for Saxony and Thuringia.
 6. Cf. Deutsche Bundesbank 1993 (note 5), p.122f. and 'Protokoll über die Satzung des Europäischen Systems der Zentralbanken und der Europäischen Zentralbank', in *Bundeszentrale für Politische Bildung 1992* (note 1), p.190ff.
 7. Cf. §§ 3 and 12 of the Bundesbank Act and article 105 and 107 of the EEC treaty.
 8. Cf. the 'Protokoll über einige Regelungen betreffend das Vereinigte Königreich von Großbritannien und Nordirland', *Bundeszentrale für Politische Bildung 1992* (note 1), p.233ff.
 9. *The Times*, 23 Jan. 1993, quoted after PA 6/1993: 14. The article also mentions that the City now increasingly favours an independent central bank.
 10. Andreas Busch, *Neokonservative Wirtschaftspolitik in Großbritannien. Vorgeschichte, Problemdiagnose, Ziele und Ergebnisse des 'Thatcherismus'* [= Beiträge zur Politikwissenschaft, Bd. 41] (Frankfurt/Main: Peter Lang, 1989), p.67.
 11. Alesina, 'Politics and business cycles in industrial democracies' (note 4).
 12. See John T. Woolley, 'Policy Credibility and European Monetary Institutions', in Alberta M. Sbragia (ed.) *Euro-politics: Institutions and Policy-Making in the 'New' European Community*, (Washington, DC: The Brookings Instn., 1992), pp.157-90; and, especially for the theory of political business cycles, Alesina, 'Politics and business cycles in industrial democracies' (note 4).
 13. For the concept of the 'Non-Accelerating Inflation Rate of Unemployment' see e.g., Paul A. Samuelson/William D. Nordhaus, *Volkswirtschaftslehre. Grundlagen der Makro- und Mikroökonomie* (Köln: Bund-Verlag, 1987, 8. ed), pp.347-55.
 14. 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.
15. Douglas A. Hibbs, 'Political Parties and Macroeconomic Policy', *The American Political Science Review* 71 (1977), pp.1467-87.
 16. Alberto Alesina, 'Macroeconomics and Politics', in Stanley Fischer (ed.) *National Bureau of Economic Research Macroeconomics Annual* (Cambridge, MA: MIT Press, 1988), pp.55-98.
 17. As an example see the recent lowering of the credit rating for Italian government bonds by the rating agency Moody's (*Neue Zürcher Zeitung*, 7 May 1993, p.14).
 18. Cf. Woolley, 'Central Banks and Inflation' (note 4), p.345 and 'Policy Credibility and European Monetary Institutions' (note 12).
 19. Woolley, 'Policy Credibility and European Monetary Institutions' (note 12), p.171.
 20. Alesina, 'Macroeconomics and Politics' (note 16) and 'Politics and business cycles in industrial democracies' (note 4); Busch, 'The Politics of Price Stability' (note 4).
 21. Busch, 'The Politics of Price-Stability' (note 4).
 22. 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 Jan. 1992, pp.21ff.
 23. For a more detailed picture of data and results see Busch, 'The Politics of Price-Stability' (note 4), p.37ff.
 24. Andreas Busch, 'An "Economic Miracle"? Die Wirtschaftspolitik der Regierungen Thatcher' in Roland Sturm (ed.) *Thatcherismus - Eine Bilanz nach zehn Jahren* (Bochum: Brockmeyer, 1990), p.139.
 25. Arend Lijphart, *Democracies. Patterns of Majoritarian and Consensus Government in Twenty-One Countries* (New Haven, London: Yale UP, 1984), p.8; cf. also R.M. Punnett, *British Government and Politics*, 5th ed. (Aldershot: Dartmouth, 1987), p.179.
 26. Quoted after Joachim Jens Hesse, Arthur Benz, *Die Modernisierung der Staatsorganisation. Institutionspolitik im internationalen Vergleich: USA, Großbritannien, Frankreich, Bundesrepublik Deutschland* (Baden-Baden: Nomos, 1990), p.79.
 27. Philip Norton, *The British Polity*, 2nd ed. (London, NY: Longman, 1991), p.50f.; Lijphart, 'Democracies' (note 25), p.6f.
 28. Norton, *British Polity* (note 27), p.20ff, 227f.
 29. *ibid.*, p.62f.; Hesse/Benz, 'Die Modernisierung der Staatsorganisation' (note 26), p.138f.
 30. Hesse/Benz, 'Die Modernisierung der Staatsorganisation' (note 26), pp.79-86.
 31. Norton, 'The British Polity' (note 27), p.62f.
 32. Fritz W. Scharpf, 'Die Handlungsfähigkeit des Staates am Ende des Zwanzigsten Jahrhunderts' in Beate Kohler-Koch (ed.) *Staat und Demokratie in Europa*. 18. Wissenschaftlicher Kongreß der Deutschen Vereinigung für Politische Wissenschaft (Opladen: Leske & Budrich, 1992), pp.93-115.
 33. cf. Hesse/Benz, 'Die Modernisierung der Staatsorganisation' (note 26), p.125f.
 34. Punnett, 'British Government and Politics' (note 25), p.198f; Norton, *British Polity* (note 27), p.211f.
 35. A.V. Dicey, *Introduction to the Study of the Law of the Constitution* (London: Macmillan, 1931), p.37f.
 36. Oscar W. Gabriel (ed.) *Die EG-Staaten im Vergleich. Strukturen, Prozesse, Politikinhalt* (Opladen: Westdeutscher Verlag, 1992), p.454f.
 37. At least in the sense of a single, all-comprising document.
 38. Norton (note 27), p.79.
 39. Busch, 'The Politics of Price-Stability' (note 4).
 40. Lijphart, 'Democracies' (note 25), p.178.
 41. Rudolf Wildenmann, *Die Rolle des Bundesverfassungsgerichts und der Deutschen Bundesbank in der politischen Willensbildung. Ein Beitrag zur Demokratietheorie* (Stuttgart: Kohlhammer, 1969), p.10.

42. Short of changing or abolishing its legal foundations, which seems to be quite high a hurdle.
43. Alesina, 'Politics and business cycles in industrial democracies' (note 4), p.83.
44. Caesar, 'Der Handlungsspielraum von Notenbanken' (note 4), p.361ff.
45. Busch, 'The Politics of Price-Stability' (note 4).
46. For the following see Mark Swinburne, Marta Castello-Branco, *Central Bank Independence: Issues and Experience* [= IMF Working Paper, June 1991] (Washington DC: IMF, 1991), Robert Pringle, Interview with Don Brash, Governor of the Reserve Bank of New Zealand, in *Central Banking*, London, 4 June 1991, reprinted in PA 43/1991, pp.15-16 and OECD, *OECD Economic Surveys. New Zealand 1993* (Paris: OECD, 1993).
47. OECD Economic Surveys (note 46), p.46.
48. Ibid., p.47ff.
49. Quoted after Norton (note 27), p.58.
50. Lijphart, 'Democracies' (note 25), p.19.
51. Busch, 'The Politics of Price-Stability' (note 4); Peter Hall, 'Bank's independence not the complete answer' in *The Independent*, 21 Jan. 1993.
52. *Communiqué of the European Community, Brussels, August 2, 1993*, printed in PA 53/1993, p.1.
53. *Frankfurter Allgemeine Zeitung*, 5 Aug. 1993, p.10.