Two Views of German Reunification

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Introduction

At the time of the 1990 Annual Meetings of the World Bank and the International Monetary Fund, the Group of Thirty hosted its International Banking Seminar. This meeting was held at the Federal Reserve Board in Washington, DC, on September 24, 1990. There, Dr. Hans Tietmeyer, member of the board of the Deutsche Bundesbank, made a speech on "The Economic Integration of Germany—Problems and Prospects."

Later that week, on the 28th, at a Plenary Session of the Group of Thirty, Dr. Wilfried Guth presented his paper on "German Unification and the Broader European Context."

In this volume, the Group of Thirty presents the two speeches as, "Two Views of German Unification." Dr. Tietmeyer's paper begins on page 3 and Dr. Guth's, on page 11.

The Economic Integration of Germany

Problems and Prospects

Hans Tietmeyer

On October 3, 1990, the Federal Republic of Germany and the German Democratic Republic (GDR) will be united. Unification will be brought about by way of accession of the GDR to the Federal Republic of Germany. The GDR as a separate state will disappear. On that day, political unification will take place after more than 40 years of separation and—what is even more important—of living under fundamentally different political and economic systems.

Economic unification, however, has been in full swing for almost three months. On July 1, 1990, the State Treaty, or *Staatsvertrag*, entered into force, establishing a monetary, economic and social union of the two Germanys. The State Treaty recognizes that economic integration of two countries that differ as widely in institutional and constitutional arrangements and in monetary and real economic conditions as the two Germanys must concentrate on three main issues:

- Harmonization of the institutional systems;
- Introduction of a common currency and a unified monetary policy; and
- Adjustment in the real economies.

Before I deal with these issues, the relative size and level of the two economies bears comparison. While the population in the GDR amounts to about 27% of that of the Federal Republic, the gross domestic product (GDP) is only about 10%. Estimated labor productivity as well as monthly compensation per employee are around one-third of those of the Federal Republic.

1. Institutional Integration

In the transition of any socialist economy to a market economy, institutional reforms must include the following steps:

- The abandonment of central planning and the introduction of the market mechanism, so that prices are determined on the basis of supply and demand;
- The creation of a decentralized and competitive structure, especially through the introduction of private property rights and by the privatization of state-owned firms;
- The establishment of a two-tier banking system with private banks, and of markets for money and capital;
- The development of new tax and social security systems; and
- The establishment of new arrangements for the labor market.

Whereas other centrally planned economies have to create the institutional setting for a market system from scratch, the GDR had the option of converting, via the State Treaty, to the institutional arrangements of West Germany, including its tax system, its social security system and all its laws applying to the economy.

At the beginning of negotiations, East German representatives were not willing to make such a conversion. In particular, some of them wanted to combine their arrangements with ours to create a system based on socialist and market-oriented elements. But, during the negotiations they became convinced that such a solution would be neither feasible nor acceptable. It became clear that the only promising way forward was to adopt our system and accept that this would inevitably lead to full, rapid unification.

Thus, most of the institutional integration of the GDR and the Federal Republic was accomplished "at a stroke." Clearly, in some areas the introduction of new institutions will take time. This, for instance, applies to the creation of a federal structure in the GDR, for which the old "Länder" will have to be revived and new governmental structures will have to be created. Other institutional arrangements like the organization of an internal revenue service and the application of the West German tax system will also require a transitional period. But in general, East Germany, unlike other Eastern European countries, has been faced since July 1 with a very abrupt transition to a market economic order.

In principle, the GDR will take over the West German social security system; however, pensions in East Germany are determined on the basis of past and actual wages and unemployment benefits are linked to the previous wage income. Therefore, during a transitional phase, old age pensions, unemployment benefits and welfare payments will differ between the two Germanys. This will help the adjustment efforts of most East German firms, which are barely competitive.

2. Monetary Integration

There were two options for monetary integration of the GDR and the Federal Republic: a gradual and an instantaneous approach. The gradual approach with two currencies coexisting for a certain period of time would have had the advantage, from an economist's point of view, of using the exchange rate as a shock absorber for East German industry, thus maintaining price competitiveness for East German companies for a time. This approach would also have eased the transitional difficulties involved in adjusting wages and the social security system and would have shifted the problem of the conversion of debt and liabilities to the end of the transitional period.

But the use of two currencies would not have stopped east-west migration, and it is most uncertain whether the East Germans would have been willing to continue to accept their own currency during the transition period. For these reasons and in view of the political aim of unification, the West German government opted for the instant solution.

On July 1, 1990, the East German currency was replaced by the West German D-Mark (DM)—an operation without precedent in modern economic history. In line with the provisions of the State Treaty, the Bundesbank took over as the central bank in East Germany from the first day onwards; only the Bundesbank Act and regulations issued by the Bundesbank have applied in the field of monetary policy since then.

Technically, the operation was performed without major hiccups; indeed, it was judged by many commentators as a "masterpiece made in Germany." Economically, it has been a success as far as can be judged after less than three months. In line with its philosophy of a "capacity-oriented" monetary policy, the Bundesbank wanted conversion rates set so that the D-Mark money supply would increase roughly in proportion to the increase in productive capacity that came from adding the East German to the West German economy. Although the conversion rates were finally set to reflect what was socially acceptable in East and West Germany, the actual outcome was very close to the Bundesbank's objective. As I noted at the outset, the productive capacity of the GDR is roughly 10 to 15% of West Germany's. At an average conversion rate of 1.8:1 for financial stock variables, the increase in the money supply (M3) of roughly DM 160 billion is only slightly above 10% of the recent level of M3 in the Federal Republic, DM 1,220 billion. With part of the new D-Mark assets going into bonds and other interest-bearing assets, the actual increase in M3 is approximately in line with our monetary target.

So far there has been no inflationary push in the GDR as a result of the introduction of the D-Mark. Prices in East Germany appear to have dropped recently, underlining the fact that the "monetary overhang" has been low in the GDR compared with other Eastern European countries. In July and August consumer prices in the GDR were about 5% below the level of last year, while the price structure was, of course, different because of the abolition of the high subsidies in the food sector.

The Bundesbank has established a network of regional branches in East Germany and is applying its regular monetary policy instruments in this area too. Differences in the velocity of money turnover and in interest rate elasticity in the GDR compared with West Germany are temporary phenomena without serious implications for the management of the money supply in the currency area as a whole.

3. Real Economic Integration

The integration of the real economies of the two Germanys adds the relatively well-qualified labor and the largely obsolete capital stock from East Germany to the West German economy.

The structure of the economy in East Germany is even worse than we thought. Large parts of industry produce goods that cannot be sold in our competitive world. Enterprises do not have efficient trading, transport and communication systems at their disposal. And the stock of buildings, the infrastructure and the environment are seriously damaged.

But the most difficult burden of the past seems to be in the long-established habits of a great part of the population. For more than 40 years people have been indoctrinated by their socialist education and work practices. They often wait for instructions and orders instead of deciding what to do on their own. This can and will, of course, change in future, but it will take time.

The German authorities project that, through restructuring, the capital stock per worker in the area of the GDR will reach the West German level and the economic structure will tend to equalize. But this restructuring and transformation takes time. It is a J-curve process for output and employment.

At present we observe the expected initial problems in East German industry and agriculture. Industrial output is falling and unemployment and short-term employment are soaring because East German companies, facing increased international and West German competition since July 1, now find it difficult to sell their products. The transition from central planning brings to light hidden economic distortions and inefficiencies. Additionally, East Germans seem to favor West German products, which is causing a split business cycle characterized by high demand for West German goods and slumping demand for East German merchandise. To make the situation even worse, we are observing wage increases of 25 to 30% in some sectors of East German industry, despite poor competitiveness in price and quality.

The core of the adjustment process is the restructuring of industry. The combines (*Kombinate*), which formerly consisted of horizontally integrated groups of companies each comprising a whole sector of the economy, have already been broken up to some extent into subunits. They must be restructured into efficient and viable entities through a process of privatization. Now all firms are owned by a government trust agency, the *Treuhandanstalt*, which is run by impartial West German managers. The trust agency operates by using all the available market-based instruments to privatize the firms. Its main task is to prevent the preservation of industrial structures that are not viable. The restructuring process must be brought about by market forces and not by political process, especially not by permanent subsidies.

For a successful restructuring of the East German industry, other essential conditions must be established:

- Clarify existing uncertainties about property rights and about the distribution of costs of cleaning up soil contamination;
- Create the right conditions for the establishment of new and small firms to absorb employees laid off through restructuring the inefficient combines; and
- Prevent wage increases from outstripping productivity gains during the transitional period.

4. Financial Transfers to East Germany

To supplement the necessary private capital flows, substantial government transfers from West to East Germany will be needed:

- For financing the budget deficit of the GDR, especially during the time when tax revenue will be low;
- For contributing to the social security system in the transitional phase;

- For alleviating structural problems resulting from the lack of competitiveness of East German industry; and
- For taking over the foreign debt of East Germany.

Although it is extremely difficult to assess the necessary transfer amounts, current estimates indicate the need for at least DM 40 billion in 1990 and DM 60 billion in 1991. Such transfers could increase the overall German budget deficit to DM 70 billion in 1990 and to DM 100 billion in 1991. In comparison, from 1985 to 1989, the average West German budget deficit—federal and Länder governments, local authorities and social security funds—amounted to roughly DM 25 billion a year. However, it is important to stress that public transfers from west to east and the resulting deficits should not be seen as pure costs to the West German taxpayer. These costs will only arise during the transitional period of economic integration. In the long run the country as a whole will benefit from the East German economic revival and from the gain in productivity that will result from the increased division of labor within Germany.

In the Bundesbank's view, unrestrained borrowing on the capital markets by German public bodies to finance German unification does not constitute an appropriate option. Rather all public bodies should now cut spending radically to minimize their use of the capital markets. So, if the federal government wishes to raise the necessary funds without raising taxes, it must undertake a radical review of the present pattern of all public expenditures. For, if transfers are financed largely by bonds, there could be pressure for interest rates to rise and for monetary policy to become more restrictive to counter an overly expansionary fiscal policy.

The pressure on domestic resources will be contained, however, to the extent that West Germany succeeds in shifting the transfer of real resources from exports to the GDR. This process has already started. Germany's exports have been growing only moderately during recent months while demand for imports has been increasing strongly.

Equally, Europe, the United States and other countries are experiencing an increase in demand for their export products. The economic integration of the two Germanys will be a growth stimulus for Europe and the world economy. At the same time, of course, capital exports from Germany, which have amounted to DM 120 billion a year in the last few years, will shrink and borrowing will generally become more expensive. The reduced capital outflow from the D-Mark area will also tend to strengthen the exchange rate of the D-Mark.

5. German Economic Integration as a Model for Eastern Europe

With economic reforms in progress almost everywhere in Eastern Europe the question may be asked, to what extent the economic reform process in East Germany can serve as a model for other Eastern European countries? While the problems connected with the transition from a centrally planned economy to a market economy are similar in all countries, the specific method of transition used in the context of German unification cannot be applied to other countries:

- German economic and monetary union means the abolition of the East German currency and East Germany's complete loss of sovereignty in monetary and economic policy matters.
- Unification also means the abrupt transition to a market economy with all the readjustments in prices, incomes, industrial and agricultural competitiveness, foreign trade and so forth.

Given the prospect of an early political unification, policymakers accepted these dislocations and the costs of the financial transfers from the Federal Republic needed to cushion the economic and social consequences of the restructuring process.

All in all, I am optimistic. After some years of difficult and painful adjustment and transition, we will see a prospering part of the unified German economy in the former East German area, provided the appropriate political decisions are made. The West German economy is now in good shape. It can bear the new burdens, if policymakers are willing and able to choose the right priorities. A historic opportunity such as this cannot be allowed to pass.

German Unification and the Larger European Context

Wilfried Guth

With effect from October 3, 1990, Germany will be reunited politically. While economic unification began midyear, when the D-Mark (DM) was introduced in East Germany, it is this political union that will truly mark the end of the 45-year division of Germany into two states. These states not only belonged to diametrically opposed political systems but also directed their economies along completely different courses.

Thus, Germany is currently experiencing the most exciting period in its postwar history. Political and economic unification is a matter of great joy and satisfaction for all Germans. Once this final step is taken, we will breathe a sigh of relief, for the initial steps to unification—with two unequal governments not always acting in complete harmony, with a number of unresolved legal questions and with preelection tactics blurring real issues—has proved to be rather difficult.

1. The Economic Climate

The fact that the economic situation in the Federal Republic is presently excellent is fortunate and facilitates unification. West Germany's robust, homemade growth is receiving additional stimulus from preparations for the Single European Market, which comes into being in 1993. Corporate investment is showing a marked increase, owing to high-capacity utilization, full order books and a strong improvement in earnings during the last few years. Construction investment is benefitting from the tight situation on the housing market—owing to, among other things, the high number of immigrants from Eastern Europe. (During the last one-and-a-half years alone, 1.2 million East Germans and ethnic

Germans have come to the Federal Republic.) The increase in private consumption in 1990 of roughly 5% in real terms will be the strongest since the early 1970s. Furthermore, our economy is also benefitting from strongly rising deliveries of goods to East Germany as well as from purchases by East German citizens in the Federal Republic.

Foreign trade though is having a dampening effect on growth. German exports are increasing at a considerably slower pace in 1990 than last year, owing to the less vigorous economic activity in major partner countries (in particular, the USA and the UK) and to the high external value of the D-Mark. On the other hand, our imports are expanding two-and-a-half times as strongly as exports this year, due to our dynamic domestic demand and the rising deliveries to East Germany. These trends in foreign trade are desirable from an international perspective because they will reduce our high trade surpluses, which have been constantly criticized by our partners in recent years. This year we expect a decrease in the balance on current account of over DM 20 billion (to around DM 80 billion).

Overall, we put real economic growth in the Federal Republic at just under 4% in 1990.

Developments next year will depend not least on the outcome of the Persian Gulf crisis, which nobody can predict today. But what seems already clear is that, due to increased oil prices, inflation dangers have increased worldwide. Together with the widespread fear of a recession in the USA, this has led to uncertainty on the financial markets. The world economy is becoming altogether more vulnerable.

If the oil price comes down again to a level not much above the price before the Persian Gulf crisis broke out, say $25 per barrel, we would assume that next year growth in West Germany will only decline moderately, to roughly 3%. But things could, of course, look different if much higher oil prices were to prevail.

2. Restructuring

In East Germany, the economy has entered a phase of "creative destruction," as Schumpeter called it, a radical change from a socialist command economy into a social market economy. It is indeed a "shock therapy" in the fullest sense that is presently being applied and, as in medicine, this is not an easy treatment. To enable the East German economy to survive in the free world economy, the widely uncompetitive industrial sector must be streamlined and rendered competitive; large parts of it will have to be closed down, a most painful procedure for all involved. A services and commercial banking sector and, in particular, a communications network have to be built up more or less from scratch; a state-run economy must be privatized. All this is a tremendous challenge. That these radical changes would involve dramatic setbacks was only to be expected. This development is reflected in the East German unemployment figure. Out of a total labor force of about 8.8 million, unemployment reached 360,000 by the end of August, coming from a highly artificial zero count. One can add to this a good 1.4 million short-term workers, who to a large extent are unemployed in practice.

The reasons for the transitional difficulties in East Germany are quite obvious. It is above all the East German economy's lack of experience on the world market that is proving a great handicap; many East German products are not competitive as regards technology, quality and design. The psychological factor—that East German citizens often abstain from buying homemade products even if imported goods are not better—will act as an additional strain, at least in the short term. East German ability to think in market terms is totally underdeveloped and there is a particular lack of management experience in such fields as marketing and finance.

It is now becoming evident that the assumption, widespread in our western countries, that East Germany had a remarkably good economy within the eastern bloc, was based on false statistics and insufficient knowledge of the situation as it really was. The facade of the late Stalinist command economy has collapsed like a house of cards. While people in the GDR recognize this clearly, it is nevertheless not easy for them to adjust to the entirely different methods and mentalities of a market economy. Added to the economic shock there is, so to speak, a "culture shock."

The reform process has also been impeded by the sluggish progress in the privatization of state-owned companies and by the somewhat hesitant inflow of West German and foreign investment capital into East Germany. This is primarily due to the fact that the trust agency (*Treuhandanstalt*), which is in charge of privatizing 8,000 state-owned East German combines (*Kombinate*) and revamping East German industry, has been burdened with a task that is almost too demanding for a newly established institution, especially as there is a great shortage of qualified personnel. Since it was set up, however, the organization and top management of the trust agency have been changed and its tasks defined more clearly so that the pace of privatization should now accelerate.

So far, the cardinal problem has been the question of ownership. It has been impossible to acquire and to dispose of real estate until the legal rights of former owners have been established. So, de facto, many houses, industrial properties and building plots have been unavailable for purchase by private investors.

Now, however, the unification treaty is about to come into force. In the future, in the case of investments with significant economic importance (creating or securing jobs), the claim of former owners to restitution of expropriated property will become void. Instead, they will receive adequate compensation.

West German and foreign investors have already made considerable commitments in the banking and insurance sectors and, recently, in the vehicle and power industries in East Germany. After October 3, we can expect fresh commitments and an increased inflow of capital. A greater involvement of foreign companies would be particularly desirable; it would intensify competition, stimulate hesitant German companies and counteract the idea that East Germany is reserved for German business. I assume that Mr. Rohwedder, the new leader of the government trust agency, who is a very capable and experienced West German entrepreneur, will make this point clear during his canvassing trips to foreign countries in the coming weeks.

Moreover, the fact that 130,000 small and medium-sized new business enterprises have been set up in the past few months shows that entrepreneurial spirit is not lacking among the East Germans. The government incentives for investments in East Germany, which have been increased, are another reason for optimism. Investments in East Germany will be assisted until mid-1982 by subsidies of up to 33%, which considerably exceed the aid granted to the former so-called development areas in the Federal Republic.

Looking ahead, the pent-up demand of East German consumers, the high demand for investment in the corporate sector and infrastructure as well as a good number of sufficiently trained and highly motivated workers will make East Germany attractive as a location for investment. There is more than a fair chance of the eastern part of Germany becoming a prosperous economic region with vigorous growth in the future. Once a turning point is reached, hopefully in the first half of 1991, we expect growth rates comparable to those in the Federal Republic in the early 1950s (between 7 to 10% per annum), which should bring East German living standards close to those in West Germany in the second half of the decade. This process could bring the all-German growth rate to 3.8 to 4%

per annum, which will also benefit our trade partners throughout the world. The growth impact for other European Community countries in 1991 is estimated by the EC Commission at 0.25%, and over the medium term it should add half a percentage point per annum to total EC growth.

3. The Outlook for Public Sector Deficits and Interest Rates

What consequences can we expect from the process of unification regarding public finance and German interest rates?

The Federal Republic is assisting the restructuring in East Germany with high official transfers. For the year 1990, my very rough guess would be that official support in the various forms and from various sources will come close to DM 70 billion. The budget deficits of central, regional and local authorities in Germany as a whole could reach a good DM 100 billion this year and about DM 130 billion in 1991. So, in relation to gross national product (GNP), this consolidated public sector deficit will reach rather high levels—3.75% in 1990 and 4.5% in 1991. This should be only a temporary deviation from the successful West German consolidation policy of the last few years. And, it should be a strong reason to make use of *all* potential savings in public sector budgets, particularly the abolition of subsidies, especially if the federal government is to avoid increasing taxes—something it would consider only as a last resort.

The large East German capital requirements are undoubtedly a burden on the German capital market. However, in my opinion, there is no reason for dramatizing the situation. This year, current saving by households in the Federal Republic of Germany will amount to roughly DM 200 billion; their total financial assets (net) are estimated at more than DM 2,500 billion. Against this background temporarily high public-sector borrowing is not too problematic; moreover, German enterprises, given their mostly good profit situation, will be able to finance their new capital expenditures to a large extent without recourse to the capital market. Finally, we should not ignore German access to global capital markets.

In my view, the current German interest rate level (slightly above 9% at the long end) already covers the risk of higher borrowing requirements for East Germany. The low German inflation rate has not increased so far as a result of the unification process. With effect from July 1 this year, the Bundesbank has assumed sole responsibility for the stability of the DM and it will not deviate from its strict monetary policy.

Still, the German rate of inflation is not likely to remain as low as in

1990. We expect it will average 2.75% this year and rise to 3.5% in 1991. On the other hand, there is no reason to expect a dramatic rise.

A stabilizing factor for prices is the trend of the D-Mark on the foreign exchange markets. Fears that the D-Mark would weaken fundamentally as a consequence of German unification have not materialized. Indeed, the opposite has occurred as the dollar has come under mounting pressure. Within the European Monetary System, the position of the D-Mark, which had been rather weak vis-à-vis the high inflation/high interest currencies of our partner countries (especially Spain and Italy), has strengthened since the beginning of the Persian Gulf crisis, owing to the greater dependence of these countries on oil imports.

All in all, and to put it in a nutshell, we might say that initially unification will be a not insignificant burden for the German economy, while in the longer run it will be a source of strength.

4. German Unification and the EC

Let me make a few comments on the political consequences of unification. We understand the unification process as a mere part—though at the same time, whether we like it or not, the focal point—of a far-reaching general process of dramatic change taking place throughout Europe. Without the democratic uprisings in Eastern Europe, which were made possible by Gorbachev's perestroika, we would not have been given the historical chance of unification and, without the continuing process of integration in the West, we would hardly have been able to take this opportunity with the approval of our allies.

Thus, the German unification process is—both economically and politically—firmly embedded in the movement towards economic, monetary and political union in the EC and closely linked to the development of Europe as a whole. This is a great challenge and responsibility for a united Germany. We have been confronted by our partner countries with concern that Germany would become too powerful and dominate European developments in the West and East. It is true that a unified Germany, after the difficult transition period, will be by far the strongest economy in Europe, and there is no doubt that economic strength gives political clout. However, this increased political weight of Germany will, so to speak, be absorbed in the process of European economic, monetary and political integration. Thus, it will in years to come give greater weight to the voice of the Community, and the Community should speak more and more with only one voice. But this one voice must by no means be the German voice. Germany has neither the intention nor the possibility to dominate decisionmaking in the Community institutions.

A number of people abroad, especially in the US, observed critically that, compared with its economic strength, Germany showed too low a profile in the early stages of the Persian Gulf crisis. In my view this criticism was justified and now Chancellor Kohl has corrected this initial mistake. It is obvious that the increasing strength of a unified Germany would be inconsistent with isolation from world politics. On the other hand, even a unified Germany is too small to act as a superpower (and it will take care not to do this). As mentioned before, it must bring its strength into joint European politics.

5. European Economic Integration

So far, progress towards a Single European Market has been encouraging. At the official level, around 70% of the necessary Community decisions have been agreed, and the ambitious goal of "Project 1992" is clearly in reach. But there are still important unresolved issues. Among them the question of harmonization of indirect taxes is perhaps the most unsatisfactory, at least from the German point of view. There are also some other impediments that stand in the way of abolishing border controls as intended. However, the five countries that have signed the Schengen Agreement will do this at the beginning of 1992, and some other countries, among them Italy, have signaled that they might join the group.

Another matter, not directly connected with "Project 1992" but with a major impact on the non-EC countries and world trade in general, is the agricultural policy of the EC. A proposal on accelerated reduction of export subsidies will be tabled in the final negotiations of the Uruguay Round. We must hope that it will be accepted in parallel with American concessions, because the collapse of the whole round would be a dramatic setback.

In the monetary and financial sphere, international capital and exchange transactions are already fully liberalized in the eight "rich" EC countries. In the Exchange Rate Mechanism (ERM) of the European Monetary System there has been a long period of exchange rate stability and a remarkable convergence of inflation rates in most (though not all) member countries. Convergence in the field of budget policies has thus far not been too impressive. On the side of external trade and payments we have high surpluses in Germany versus high deficits in the UK, but one can expect that the German surplus will diminish in the course of unification.

There have been clear indications from the British government that the pound sterling will at long last enter the ERM, probably before the end of 1990. I hope that the Persian Gulf crisis will not be taken as an excuse to postpone this overdue step again. Once there is a turnaround in the British inflation rate, which is expected in the months ahead, the time will be ripe. As Samuel Brittain never tires of writing in his *Financial Times* column, this will bring British economic and financial policies more in line with those on the continent.

On July 1 the 12 EC member states entered the first stage of Economic and Monetary Union (EMU), in line with the Delors Report. At the institutional level, the mandate for economic policy coordination by the Economics and Finance Ministers Council (ECOFIN) has been strengthened and the first round of "mutual surveillance" has taken place. In parallel, and more importantly, the Committee of Central Bank Governors has been mandated to intensify their cooperation, which means mainly to proceed from ex post exchange of information to advance consultation and coordination on national monetary policies.

Since institutional changes are required in the next stages of EMU, it has been decided that an intergovernmental conference will convene near the end of 1990 to draft a new EC treaty on EMU and, more specifically, on the creation of a European system of central banks or, as some have called it, a Eurofed. However, the final aim of a single European currency and a single monetary policy, while being endorsed by all other member countries, is not accepted by the British government, which has submitted an alternative proposal for the second stage. Generally, there are still quite divergent views on the timing and contents of this stage. So the treaty negotiations will not be easy. On the other hand, it's encouraging that, according to Bundesbank President Karl Otto Pöhl, *all* central bank governors are in agreement on the structure, the mandate and the statutes of a future independent European central bank system.

Let me insert here some words about the German position. Some months ago, certain EC member countries expressed fear that Germany would now drag its feet regarding EC integration and concentrate all its efforts instead on national unification and the intensification of its ties with Eastern Europe. Such apprehensions were soon dissipated. Chancellor Kohl agreed not only that the turn of events in Germany should accelerate efforts toward Western European integration but he also declared, in a joint statement with French President Mitterand, that the target date for European economic, monetary and political union should be as early as January 1, 1993—an ambitious target, indeed. Personally, I think it is somewhat too ambitious.

Accordingly, European Community leaders have also decided to hold an intergovernmental conference on political union, in parallel with the conference on EMU, to strengthen cooperation in foreign and security policies and to define the role and authority of Community institutions. At the last Council meeting in Dublin, they declared that the results of both conferences should be ratified by the member states before the end of 1992.

Thus, as a consequence of its own unification, Germany has changed camps with regard to European integration: formerly on the more cautious side and concerned for monetary stability, it now feels obliged to join what we could call the "pressure group," consisting of France, Italy and Spain. Not all German politicians are comfortable with a shorter timetable, something that must ultimately be settled by Chancellor Kohl.

Now, which issues are at stake in the preparatory discussion on EMU? The 12 EC member countries have achieved broad agreement in principle on the three-stage Delors concept, with the exception of the British government. Nevertheless, different positions and attitudes need to be reconciled at the upcoming official discussions.

First, the timing of the transition from the first to the second stage of EMU raises the perennial conflict between two different schools of thought. On the one hand, the Germans and Dutch claim that national *economic* policy concepts and performance must converge to a high degree before the next institutional move in *monetary* integration can be made. (At least this is the perspective in the Bundesbank. I have mentioned the somewhat different attitudes and orientations within the political leadership.) On the other hand, to achieve economic convergence, the so-called monetarists, especially the French and Italians, prefer to rely on the positive, disciplining effects of monetary rules and obligations. In any event, this has to be a *political* decision.

Let me now take a brief look at the British government's recently published alternative for the second stage. It provides for the introduction of a "hard ecu"—namely, an independent, non-basket currency that is to be managed by a European Monetary Fund so that it will never devalue vis-à-vis the strongest EC currency. At first sight, this proposal would indeed seem to accommodate the diverse concerns of the various groups of EC countries. However, on closer examination, the proposal's technical aspects and institutional implications raise strong reasons for skepticism.