European Monetary Policy: Theory, Practice, Empirical Experience, 2nd edition, Werner Verlag 2001 (together with E. Görgens and K. Ruckriegel): Indroduction

This textbook aims to give a detailed, systematic explanation of new developments in European monetary policy as it has been conducted since the beginning of 1999 and to combine them with traditional insights. For example, the transition to Stage Three of EMU has gone hand in hand with a change in the method of quoting exchange rates, namely from direct quotation to indirect quotation; therefore the latter will be used throughout this book. On the other hand, the issue of what monetary policy strategy is adequate and the monetary transmission process will be discussed here, bearing in mind the existence of known alternatives yet also taking into account changes in the underlying framework. The fact that this monetary policy regime is new, however, will mean that some of this book's statements will tend to be speculative, which is unusual for textbooks.

Chapter I explains why monetary union started with 11 countries. In this connection, the conditions for entry, also known as the convergence criteria, are explained in further detail, since they will be applied-in a modified fashion-to further candidates for accession and also, in part, to the present members in the coming years.

Chapter II begins by covering the institutional framework in which the single monetary policy has been active since 1999. The centrepiece is formed by the structure and tasks of the Eurosystem and an analysis of the aspect of independence. The generation and use of profits in the Eurosystem is also discussed.

The second section of Chapter II discusses various monetary policy strategies and their adequacy to the Eurosystem. A monetary policy strategy is defined as the basic thrust of monetary policy in order to achieve the desired goals. Besides strategies focusing on interim targets (e.g. interest-rate targeting or monetary targeting), the relatively new strategy of direct inflation targeting, as well as a multi-indicator strategy modelled upon that of the Federal Reserve System, are the subject of analysis. Finally, the strategy embarked upon by the Eurosystem is discussed, including arguments for or against the various choices.

The third section deals with the Eurosystem's set of monetary policy instruments. Together with the Eurosystem's banknote-issuing monopoly, the new minimum reserve system forms the basis for the banking system's dependence on the central bank for funds and stabilises the overnight money market through its operational design. Within the framework of credit institutions' refinancing with the Eurosystem, open-market transactions, especially the weekly main refinancing operations, play a crucial role. They are accompanied by the standing facilities, i.e. the marginal lending facility and the deposit facility. The individual instruments are described, and their effects characterised, using the consolidated balance sheet, the "financial statement", of the Eurosystem.

The decisive field of monetary policy operations is the money market. The interest rate on main refinancing operations is the key interest rate for overnight money lent among banks (overnight money). The Eurosystem, as the sole supplier of central bank money, can manage either the price (the interest rate) or the quantity; the Eurosystem uses the price approach (i.e., the overnight interest rate). Section four shows how this is implemented technically. The overnight money rate, which functions as an operative target in the Eurosystem's concept, is then where the monetary transmission process begins.

The general transmission process deals with how monetary policy stimuli are transmitted from a change in central bank interest rates to the final macroeconomic objectives. It is covered in the fifth section. In particular, one must address the question as to which-in some cases, heterogeneous-national effects can be unleashed by a single monetary policy and which transmission channels will have a stronger or weaker impact in future. It will thus become readily apparent to the reader that exchange rate changes, owing to the relative lack of openness of the euro area, will in future play only a subordinate role. However, there are some reasons to believe that an expectation-induced transmission process is becoming increasingly relevant and that the credit channel may need to be reassessed.

Finally, Chapter Three is devoted to factors which could potentially disrupt the single monetary policy of the Eurosystem. The first section addresses interrelationships between monetary policy and fiscal policy. The theoretical relationships are discussed against the backdrop of the provisions of the EC Treaty and the Stability and Growth Pact. The latter sections seek to defuse the traditional potential for conflict. All the same, there do remain problems involving a lack of co-ordination between monetary and fiscal policy, which, in the final analysis, consist in temptations to shake off the burden of real government debt by means of inflation spending. This section is discussed the most extensively because of the debate over the past few years and the position of prominence occupied by budgetary policy in the Maastricht Treaty.

Furthermore, wage policy, which continues to be each member nation's individual responsibility, must take heed of the sea changes ushered in by monetary union (section two). Otherwise, wage policy, too, could cause problems for the single monetary policy. This uniformity will cause national rate of inflation to differ only imperceptibly in the long run, and it will no longer be possible to create a national competitive advantage within the euro area by means of devaluing one's currency. Accordingly, the taking into consideration of productivity developments in wage negotiations will become an increasingly relevant element of labour market developments, particularly the further development of unemployment. If unemployment cannot be brought under control within the foreseeable future, the project of monetary union could encounter increasing pressure from that side, and demands for national and/or supranational (i.e. from the EU) transfer payments could grow louder and louder.

The last issue to be discussed will be the interplay between monetary policy and exchange rate policy (section three). Responsibility for the latter is held by the ECOFIN Council, whose guidelines must be followed by the Eurosystem. If the ECOFIN council takes a formal decision on an exchange-rate system or introduces exchange-rate target zones, this could cause difficulties for a stability-oriented monetary policy via the foreign-exchange-market interventions which would be triggered off by such a decision. This problem was defused right from the outset when the exchange-rate relationships were devised between the euro area countries and the EU countries not participating in monetary union, the ERM II countries.

The contents we have selected, in our opinion, cover the core concepts of European monetary policy. A textbook that covers a project which is still in the beginning stages and is marked by dynamic growth is automatically in danger of being "overtaken by events" as it were. Therefore, in some places the book needs to rely on plausible assumptions. On the other hand, we have tried to give the reader the

opportunity to find more up-to-date information on monetary union and the euro by including a list of websites.

Every section of this book ends with a quiz on the contents of that section, the answers to which are found at the end of the book, as well as considerable bibliographical references. To make it easier for the interested reader to find literature, we refer-wherever possible-to Internet addresses where the sources we have provided can be called up. For didactic reasons, too, we have attempted not to overload the text, so as to make our train of thought easy to follow. Thus, every chapter has several boxes where a term is explained in greater detail or a line of thinking is elaborated upon. In addition, it is our goal to combine theory with current trends and data. This is reflected in the inclusion a large number of charts and tables based on empirical data.