distribution system would need to be chosen which, above all, would encourage countries to impose the tax. If that system then produced the "pennies from heaven" for development cooperation which so many hope for, that could only be a welcome side-effect.

The primary impact of a Tobin tax has to be seen as the reduction of short-term international financial flows. That is the ultimate basis of the tax's redirective purpose and hence also the key argument for its implementation. However, the danger is that speculators could skip over the Tobin-tax hurdle which would then largely relinquish its redirective function. Though this hurdle-skipping could be guarded against by imposing a higher tax rate of several percent, that would lead to major allocative distortions. Furthermore, it would create such pronounced segmentation in the international capital market that the degree of monetary and fiscal sovereignty individual countries gained ought to be regarded as a risk rather than an opportunity.66

Although there is quite a good case overall for giving a moderate Tobin tax (or similarly structured instrument)67 a try, the actual likelihood of its being implemented on a worldwide basis is extremely small. Even if it were possible to overcome the political implementation problems, the Tobin tax could only possibly fulfill a fraction of the hopes that have been placed in it. All things considered, this is not a cure for all ills but a last-resort solution which, even in the mid-1970s, Tobin recommended "regretfully" in order, as he put it, "to throw some sand in the wheels of our excessively efficient international money markets".68

66 Cf. A. Schrader: Devisenumsatzsteuer..., op. cit., p. 23.
67 See footnote 9.

Matthias Sutter*

A Currency Board for European Monetary Union Outsiders

It is becoming clear that strict interpretation of the Maastricht criteria and adherence to the 1.1.1999 as the starting date for EMU will lead to a two-speed monetary union with insiders and outsiders. In this case, the author proposes the introduction of a currency board for outsiders in order to ensure a minimum of convergence before these countries join EMU as well as to confront the danger that outsiders may become faced with longer term obstacles to membership.

The implementation of the European Monetary Union (EMU) hangs in the balance. Given the fiscal problems which exist in several EU member states it is questionable whether there will be an EMU at all. Fiscal consolidation in France is of particular significance as an EMU without France appears politically unfeasible. Germany's insistence on a strict interpretation69 of the convergence criteria laid down in the Maastricht Treaty on European Union (EUT) raises the question of when EMU will be possible.

On the one hand, watering down the convergence criteria could lead to an unstable monetary union comprising economically heterogeneous EU states, a union which could bear the seeds of its own destruction at the very moment of its birth. However, dissolving the monetary union would involve enormous costs and would deal a severe blow to European integration. On the other hand, barring individual EU members from EMU or postponing the start of monetary union for an indefinite period harbours risks of political disintegration per se and

69 In the following this is taken to mean the application without exception of the limits of 3% of GDP to the budget deficit and of 60% of GDP to a country's national debt.
also fails to solve the problems of transition to EMU. If a two-speed monetary union with insiders and outsiders is created, there is a danger that those states which do not qualify for EMU from the start (the outsiders) will face considerable difficulties in joining at a later date.

In the following I propose the introduction of a currency board (CB) for outsiders, parallel to the introduction of EMU. This is to ensure a minimum of convergence – above all adherence to the deficit criterium – before outsiders join EMU, as well as to avoid the danger of outsiders being faced with longer term obstacles to membership.

This proposal implicitly incorporates the political desirability of achieving an EMU which includes as many states as possible as a preliminary step towards further-reaching political union, but also adherence to the aim of creating a stable EMU capable of operating successfully in the long-term. On the one hand, the introduction of a currency board is intended to provide a monetary bond between EMU and outsiders in order to ease membership at a later date. This should help keep further steps towards integration – involving the EU as a whole – open and viable. On the other hand, a CB should help substantiate a culture of (fiscal) stability.

Meeting the Convergence Criteria

The now familiar convergence criteria are laid down in Art. 109j (1) of the EUT as a prerequisite for entry to EMU. The (disputed) economic logic behind the convergence criteria relating to inflation rates and national budget discipline, which have been the subject of particularly intense public debate, can be explained as follows: in addition to preventing shifts in competitiveness caused by relative differences in inflation, bringing member states’ inflation rates into line is considered to be an expression of converging economic policy preferences for price level stability as well as a convergence of the mechanisms behind this stability such as wage determination. National budget discipline is intended to avoid the European Central Bank (ECB) being compelled by excessively indebted individual EMU members to adopt an accommodating monetary policy with inflationary consequences, and to prevent other member states having to bail out heavily indebted states which have run into payment difficulties.³

In 1995, Luxembourg alone was able to satisfy all the convergence criteria, with all the other EU members failing to meet the fiscal criteria in particular. Even if the austerity programmes passed in several countries are successful, it is becoming clear that, if the convergence criteria are interpreted strictly and the 1.1.1999 starting date for EMU is adhered to, there is going to be a core monetary union which will have to include Germany and France. However, a core monetary union could impede and delay future entry for those member states covered by the special arrangement in Art. 109k EUT. This is because it is easier to satisfy the convergence criteria when within EMU than it is from outside:

☐ Judging by the present degree of (non)-fulfilment of the convergence criteria, EU members will be excluded from participation in EMU primarily because of the state of their national budgets. Such exclusion could lead the financial markets to conclude that outsiders will be unable to consolidate their state budgets in the foreseeable future, thus resulting in increased risk premiums on national debt. This would further hamper not only convergence of long-term interest rates, but also the country’s ability to satisfy the fiscal criteria.⁴

☐ Satisfying the inflation criterium is also easier to achieve through EMU membership because within EMU there is a unified monetary policy for the entire monetary area, thus eliminating differences regarding inflationary preferences in economic policy which are a frequent source of international inflation rate differences. For those states which have still to reduce their inflation rates to the (relative) level demanded by the EUT there is the additional problem that, as a result of the necessary process of lowering inflation, real interest rates continue to rise until the credibility of the country’s own monetary policy is reflected in a corresponding reduction of nominal interest rates. With rising real interest rates, the budgetary burden also increases as the country’s accumulated debt is serviced.

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² The EUT determines that an inflation rate alignment at any relative level is sufficient. An absolute upper limit would make more sense as far as ensuring price level stability is concerned.

³ Cf. M. Sutter: Public indebtedness in a Monetary Union. Comments on the Necessity of its Disciplining and Sanctioning, in: CA-Quarterly 1/96, pp. 26-33. While Art. 104b EUT excludes any responsibility of the Community or the other member states for an individual member state’s liabilities, this “no bail out“ clause cannot be regarded as being very credible.

⁴ It is conceivable, though less probable, that the opposite effect could take place, i.e. that the financial markets in the excluded countries expect particular efforts to be undertaken towards the consolidation of their public sector budgets, and honour this with more favourable conditions for public debt.