

A Yankee Recipe for a EuroFed Omelet

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The architects of the European Monetary Union (EMU) face a dilemma in trying to balance the advantages of decentralized administration against the dangers of nationalism. In this respect, the American model suggests a way to stabilize the EMU by disengaging it from everyday politics.

The map of the twelve U.S. Federal Reserve districts is an odd-looking thing. Politically and economically dissimilar states are lumped together. Some states are split in two. No state is by itself a Fed district. These boundaries make it difficult to easily identify district interests in the way one can speak of urban interests or Texas interests or Rust Belt interests, and this is precisely what is interesting and stabilizing about Fed districts.

One state's interest groups can easily organize support for a pork-barrel policy to benefit that state at the expense of the rest of the country. Fed district lines, though, discourage beggar-thy-neighbor politics by scrambling the usual coalitions constructed along state lines. Suppose a pressure group wished to lobby the Cleveland Fed for a policy detrimental to neighboring districts (say, lax credit approval standards by Cleveland's discount window).

The pressure group would have to garner support in Ohio, Pennsylvania, Kentucky, and West Virginia, four states with markedly different interests. Ohio lies completely within the Fourth District, so a consensus there might be attainable. Half of Pennsylvania, though, lies in the Philadelphia Fed's district, so that state's interest groups would be hesitant to support a policy harming eastern Pennsylvania but helping Kentucky, Ohio, and West Virginia, as well as western Pennsylvania. Similarly, half of Kentucky is in the St. Louis Fed's domain. Few West Virginia pressure groups would join the coalition, since only a tiny piece of West Virginia is in Cleveland's district.

On occasion, however, a consensus can arise in one Fed district, pitting it against the other districts.

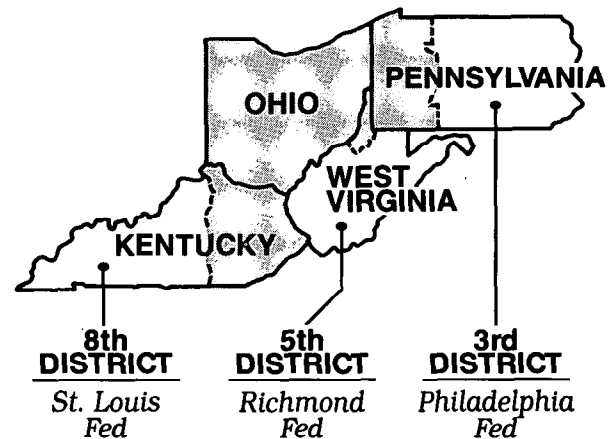
For example, a districtwide recession can lead to one-sided pressures on that district's Fed (which may have a representative on the Federal Open Market Committee) to support looser credit conditions nationally. The decentralized Fed, though, reduces the frequency of such demands reaching Washington by requiring that such pressure must filter through debate at the district level before it reaches the Federal Open Market Committee. This structure slows down the deliberative process enough that policymakers at the highest level do not have to respond to every ephemeral economic disturbance.

So, decentralization assures that disparate voices will be heard, while the jagged district boundaries assure that these voices will be organized through channels other than the usual political ones organized along state lines.

The Fed's ragged district lines offer powerful advice to the budding European Monetary Union — insulate a EuroFed from nationalistic pressures by

4th FEDERAL RESERVE DISTRICT (Cleveland Fed)

Plus portions of Pennsylvania, West Virginia,
and Kentucky in Neighboring Fed Districts



scrambling its districts' borders. Rename the Bundesbank the Frankfurt EuroFed, but let it represent only part of Germany plus part of France, with a governing board coming from both to control any tendency to favor only Germany. Rename the Danmarks Nationalbank the Copenhagen EuroFed, and let it represent Denmark plus some parts of Germany not under the Frankfurt EuroFed, and so on with all the other central banks.

In other words, design EuroFed districts that break up nationalistic pressures rather than exacerbate them, yet which still confer the other benefits of decentralized administration. Entangling member nations at the district level would also make secession from the EMU an administrative nightmare (like unscrambling an emu's egg, so to speak), and that would bolster confidence in the EMU on world markets.

A glance at the map shows that drawing twelve scrambled districts for twelve countries is harder than drawing twelve scrambled districts for fifty U.S. states. Some districts might inevitably have distinct economic interests. Undoubtedly, it would take complex negotiations to design the borders and the regional EuroFeds' voting structures. Supplemental measures might be needed to adequately insulate the EuroFeds from political logrolling. Like the district Feds, EuroFeds might be well-served by different

classes of directors representing, say, industry, labor, national governments, the banking sector, etc. To prevent any one nation from dominating a EuroFed, each district's board could include members from other countries on a rotating basis, for example, giving the London EuroFed board a succession of members from Greece, Portugal, Belgium, and so on.

The goal is to insure that national political coalitions do not easily or quickly translate into EMU pressure groups, making money just one more log to roll (eg, I'll voter tighter credit if you'll vote higher wine subsidies).

National politics would certainly inject itself into the process of drawing lines. For example, would Britain allow Northern Ireland to fall within the Dublin District? As difficult as these negotiations would be, scrambling monetary boundaries at the founding of the EMU would recognize and deal *up front* with an ugly reality — nationalism has been ripping European institutions apart for centuries. The point here is that the EMU's founders can choose to face that reality now and put it behind them. Or, they can simply string the existing central banks into a loose confederation, with each bank representing purely national interests. Then they will be sure to face the reality every day as long as the union survives.

