The reconversion of Otmar Issing

Former ECB chief economist veers again towards pessimism on European single currency

by David Marsh

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Otmar Issing, the former chief economist of the European Central Bank and the German Bundesbank, is a genial number-cruncher who believes in the overall benefits of European integration but is genuinely open to others' views. He is a key bellwether for Germany's stance on the euro. In his 75th year, nearly five years after he retired from the ECB, he is still someone to watch; particularly now he has turned virulently pessimistic over the European single currency. In a marked change from his relative sanguinity during his eight years at the ECB, he terms member countries' unreliability on economic policies 'a basic design flaw of monetary union.'

And he unashamedly says – in an essay in the January OMFIF Bulletin to be published this week – the days of the single currency may be numbered. 'The present seemingly unstoppable process towards further financial transfers will generate tensions of an economic and especially political kind. The longer this process is characterised by unsound conduct of individual member countries, the more these tensions will endanger the existence of EMU.'

In the period before he was appointed in spring 1998 to become the ECB's first board member in charge of economics, Issing won his spurs as a steadfast sceptic on European monetary integration. Chancellor Helmut Kohl grumbled about his finance minister's recommendation to appoint Issing to the ECB board, pointing out: 'He has never said a good word about the euro.' Theo Waigel, Kohl's wily finance minister, convinced the Chancellor that Issing's well-known euro doubts would help convince ordinary Germans that the future of the single currency lay in safe hands.

During his eight years at the ECB before he retired in summer 2006, Issing never went over to the side of die-hard pro-euro enthusiasts, insisting that the single currency remained an 'experiment.' And he pointed out the dangers that imbalances could lead to a constant flow of funds from better- to worse-off EMU states that could disastrously undermine political and economic confidence. But he suspended his previous disbelief. In a speech in March 2006, shortly before he retired (and took a part time job with Goldman Sachs), Issing said monetary union could succeed without political union, stressing that 'Euro area countries already share important elements of state formation which are also key to the functioning of monetary union.' He was confident that the euro's rules-based system would produce stability and declared: 'Monetary union is and will remain one of [the EU's] major success stories.'

Even after leaving office, when he wrote a book on EMU (published in English in 2008), Issing's scenarios remained largely benign, and his glass was half-full, not half-empty. He regarded the build-up in current account imbalances among euro members not as a source of weakness but as a sign of strength, on the grounds that financial integration among disparate member states allowed worse-off countries to put aside previous constraints on growth.

Now, however, after the large increase in risk premia on deficit countries' debt and the recourse to official European bail-out schemes during 2010, Issing writes, 'The resent scenario does not come as a surprise… This was a crisis that in many ways had been pre-announced. The seeds were sown some time ago… The euro members in no way represent a politically unified entirety, but they form a single currency. At the outset, and also after the start, politics failed to create the right conditions for it to work optimally.'

Cynics might say that ratcheting up euro rhetoric is all part of a German strategy to enforce tougher economic conditions on bail-outs. All this makes life more difficult for the deficit countries – but by pointing out plaintively that Europe is on the way to a 'transfer union', Issing may actually be helping to prepare the German public to accept more bail-outs.