



Euro Symposium

It Has Happened—And It Will Continue to Succeed

Otmar Issing¹

ABSTRACT

Reading the article by Lars Jonung and Eoin Drea (2010) reminded me on almost every page of my own thinking, how it evolved over time, and my experience as member of the Executive Board of the European Central Bank (ECB).

Optimum Currency Area Theory and Maastricht Treaty

Since as an academic I had read the seminal articles on optimum currency areas by Robert Mundell, Ronald McKinnon, and Peter Kenen, I was fascinated by the idea that the domain of a currency might not be determined by the frontiers of a state, but by economic criteria. It was obvious that strengthening economic integration in Europe one day could lead to a situation in which this idea might become a realistic option. However, the optimum currency area criteria were extremely demanding, so that a monetary union seemed feasible only among very few countries.

With the ratification of the Maastricht Treaty, the creation of a single currency became a concrete project, which would start with an initially unspecified

1. President, Center for Financial Studies, Goethe University of Frankfurt, Frankfurt am Main, Germany 60325.

number of countries. The treaty formulates convergence criteria that have to be fulfilled if a country wants to join the European Monetary Union. However, it was also clear that in the end the European Council, i.e., politics, would decide on participation.

Skepticism among Economists

The Maastricht Treaty triggered a discussion among politicians, academics of all kinds, and media. The reaction from economists was overwhelmingly critical, especially in the Anglo-Saxon world. The title of Jonung and Drea's paper reminds me of the comment by British observers invited to the Messina Conference in 1955 devoted to European economic integration. They departed, claiming as follows: The Continentals will not be able to agree on anything of substance. In the unlikely case of an agreement, they will not be able to implement it. However, in the hypothetical case that they realize such a project, it will become a disaster. Remember, not much later (1957) the Treaty of Rome was signed, and the establishment of the European Economic Community in 1958 set in motion a process that finally led to the single market and the European Union, which now has 27 members. Only a few years later, in 1961, Britain asked for participation. After French President Charles de Gaulle's veto, it took then more than ten years before the United Kingdom finally could become a member.

The camp of "it can't happen" had many supporters for a number of years after Maastricht. On many of my visits to the United States, either EMU was a non-issue or I was asked, "Do you really think this will happen?" The more the start of EMU seemed to become reality, the louder became the voices of the "bad idea" and "won't last" camp.

However, in Europe also a majority of academic economists was sceptical. In Germany, 155 economists published an open letter in February 1998 entitled "The euro is coming too early" (Issing 2008). I myself, as member of the Executive Board of the Deutsche Bundesbank, had warned against a premature start of EMU in a number of publications and speeches.

After nomination for the Executive Board of the European Central Bank, every candidate had to testify before the European Parliament.² In my hearing on May 7, 1998 (a few weeks before the board's first meeting, on June 1), I explained:

The dismantling of all trade barriers, the free movement of persons—in short, the four great economic freedoms—were the grand objective that

2. In my first weeks in office, I received a letter by Milton Friedman offering "congratulations on an impossible job." On several occasions he predicted the collapse of the euro within the next five years.

was achieved with the single market. I will not deny that I was more hesitant with regard to monetary union—not as regards the grand goal, which was always the culmination, the completion of integration, but rather out of concern about the great leap. Concern because I know, or think I know, what monetary union means, what its consequences are for many economic and political spheres beyond the monetary one... To be frank, I would not have thought it possible that, before the start of monetary union, Europe—that is, the eleven countries we are talking about here—would attain virtual price stability and that Germany's inflation rate would be no better than the average! A few days ago, Eurostat released the March inflation figure: 1.2 per cent. Now that is price stability!

My concerns have not entirely disappeared, however, as Europe has not made similar progress with convergence in all areas of the economy. Here a lot remains to be done...

The introduction of the euro will change the face of Europe. The introduction of the euro is the most significant event in the world of international money and finance since the end of the Second World War. The euro will only be able to play its intended role if it is a stable currency. To achieve this, the Maastricht Treaty gives the European Central Bank clear priority for the goal of price stability and endows its decision-makers with independence so that they can take the necessary decisions to achieve that end. (Issing 2008)

The Euro Has Become a Success

There is nothing more convincing than success. After 11 years of existence, the euro is seen worldwide as an overwhelming success (Issing 2009). From the start it was appreciated as a stable currency and inflation expectations remained firmly anchored most of the time consistent with the European Central Bank's definition of price stability. Challenges like Y2K, 9/11, and, most important, managing the recent financial market crisis were mastered in a way which confirmed the reputation of the ECB as a key player in the world of central banking. So it did not come as a surprise that within a few years the euro found its position as the second most important international currency after the U.S. dollar.

Considering all the critical reservations how can this success be explained? The answer lies on two different but related levels.

In contrast to many skeptics' expectations, the ECB has conducted a stability-oriented monetary policy not influenced or undermined by national interests, but devoted to maintain price stability in the euro area as a whole. The stability-oriented monetary policy strategy was the foundation for taking the appropriate decisions during all challenges (for a detailed analysis, see Issing 2010). The "two-pillar" strategy of using both money-supply growth and other economic indicators to analyze risks to price stability was initially widely criticized, but it has demonstrated its advantages, not least in the context of the financial market crisis and the discussion about the appropriate reaction to asset price developments (Issing 2009). In short, the euro and its stability have worked as the anchor for the coherence of EMU.

In the context of this experience, the discussion on optimum currency areas has continued. A preliminary summary might conclude that the optimum currency area criteria are not exclusive, and their fulfilment may to a certain extent be endogenous to membership in the currency union (Issing 2004). The jury is still out on the question to what extent EMU and the single monetary policy might work as a catalyst for needed reforms (Alesina et al 2008).

The change in the attitude of economists, especially in the United States, could be observed by a series of panels organised by Dominick Salvatore at the occasion of the annual meetings of the American Economic Association. After very critical reactions before the start of EMU, the panelists and the audience became more and more positive about the future of EMU as the years passed.³

Will It Last?

Eleven years are a short period in the life of a currency. A successful start and mastering severe challenges are a foundation for the future, but of course no guarantee. The ECB, with its independence and a clear mandate for maintaining price stability—enshrined in an international treaty which concerning these provisions can be changed only unanimously—will remain an anchor of stability. The other pillar of EMU, solid public finances, is under severe stress. With budget deficits exploding, the Stability and Growth Pact is ahead of a dramatic challenge. Further reforms for greater flexibility are badly needed.

Sceptics are not convinced by the successful first eleven years and see the major challenges only coming, not least due to large internal imbalances. However, for member countries EMU is without any reasonable alternative, in

3. Panelists were C. Fred Bergsten, Rudiger Dornbusch, Martin Feldstein, Peter Kenen, Ronald McKinnon, Robert Mundell, and Michael Mussa.

political as well as in economic terms.⁴ Therefore, there are important reasons to expect that this situation will finally enforce needed reforms and fiscal discipline.

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4. On the issue of the need for a political union, see Issing (2009).

About the Author



Otmar Issing is University Professor and President of the Center for Financial Studies at the University of Frankfurt and Honorary Professor of the University of Würzburg. He was a member of the board of the Deutsche Bundesbank from 1990 to 1998 and a member of the Executive Board of the European Central Bank from 1998 to 2006. Among many special honors, he was the recipient of the International Prize of the Friedrich-August-Hayek Foundation in 2003. His books include *The Birth of the Euro* (2008) and *Einführung in die Geldtheorie* (Introduction to Monetary Theory), which has had 14 editions.

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