

THE BIRTH OF THE EURO

Today, 318 million people in 15 countries use the euro, which now rivals the importance of the US dollar in the world economy. This is an outcome that few would have predicted with confidence when the euro was launched. How can we explain this success and what are the prospects for the future?

There is nobody better placed to answer these questions than Otmar Issing, who, as a founding member of the Executive Board of the European Central Bank, was one of the euro's principal architects. His story is a unique insider account, combining personal memoir with reference to the academic and policy literature.

Free of jargon, this is a very human reflection on a unique historical experiment and a key reference for all academics, policy-makers and 'eurowatchers' seeking to understand how the euro has got to where it is today and what challenges lie ahead.

OTMAR ISSING is President of the Center for Financial Studies at the University of Frankfurt and Honorary Professor of the Universities of Frankfurt and Würzburg. He is a former member of the Board of the Deutsche Bundesbank (1990–8) and a founding member of the Executive Board of the European Central Bank (1998–2006).

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Translated from the original German
by Nigel Hulbert



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Preface

The date 1 January 1999 marks a milestone in monetary history. Eleven national currencies – not least among them the D-Mark, held in such high esteem by the citizens of Germany – ceased to exist. Their place was taken by the euro, as the single currency for over 300 million people. In the meantime, the euro area has grown, and now encompasses a total of fifteen countries.

The birth of the euro is a unique event. Never before had sovereign states ceded their responsibility for monetary policy to a supra-national institution. This constellation – on one side, a central bank (the European Central Bank, ECB) and a single monetary policy; on the other, nation states that largely retain their competencies in the areas of economic and fiscal policy – creates a particular kind of tension in the interrelationship. Quite a few observers, with probably the majority of economists to the fore, were more than sceptical as to the outcome of this experiment. To begin with, will the euro get off to a good start? Under the prevailing circumstances, how likely is it, if at all, that the euro can be a stable currency? And then: what about the future? Can European monetary union (EMU) survive in the absence of political union?

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The subject has been comprehensively addressed both by economists and in the media. Since well before the start of EMU, and even more so afterwards, there has been a vast output of economic research. Hardly surprising, in light of the fact that the political decision presented economists with a special kind of experiment whose many different facets offer broad scope for in-depth theoretical and empirical studies. Among economists, as in the media, the pendulum has swung back from a predominantly sceptical assessment towards regarding the experiment as having been successful – initially with some surprise, but meanwhile almost as though it could have been taken for granted. After nine years, most observers pronounce the ECB and the euro to be an unqualified success. In so doing, they tend to forget just how difficult it was to prepare for the start of EMU, to build up the ECB as a new institution, and to lay the foundations for a single monetary policy.

This volume describes the road to the euro, and the setting-up of the ECB and of the single monetary policy, from the vantage point of one who was closely involved in a leading position. After leaving academia in October 1990 to join the Directorate of the Deutsche Bundesbank, I was appointed to the Executive Board of the European Central Bank on 1 June 1998, the date of its foundation, and hence placed at the centre of this unique event. Being responsible for the Directorates General for both Economics and Research, I was called upon to play a key role, in particular in the preparatory stages and the early days of the single monetary policy. To be confronted with what was in every way a special challenge, and at the same time to be granted the opportunity to help shape the response to it: what more interesting task could an economist ever hope to be given?

In this book, my aim is to let the reader share this experience of what is probably the most exciting event in modern monetary history. To that end, I analyse the gestation and birth of the euro from an economist's perspective, and at the same time describe the process of and background to the setting-up of such an important institution

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as the ECB. On the one hand, as a supranational institution, the ECB is a special kind of central bank; on the other, the ECB and its monetary policy can serve as the model of a modern central bank in general. The closing chapters look to the future, to the challenges that lie ahead for the ECB and European monetary union.

This mix of economic analysis and historical narrative determines the flavour of the book. Most chapters are quite approachable even for readers without any major grounding in economics. In certain sections, such as that dealing with the choice of monetary policy strategy, the need to consider the background of economic analysis and research is a determining factor.

The bibliographical references are for the most part to other works by the author. Their publication was largely contemporaneous with the processes described in the present volume and they serve to illustrate how every step, every decision taken was accompanied by intensive economic discussions within the ECB, in particular with my own staff. In turn, these publications contain extensive references to other literature. The book should therefore form a useful starting point for students and those wishing to pursue the topic further.

The present work is a reflection of the successful collaboration with my colleagues in the Directorates General for Economics and Research. I shall never forget the way in which they supported me in accomplishing my tasks through their outstanding professional competence, their commitment and their loyalty.

For their many valuable comments and criticisms, I should like to thank Marcel Bluhm, Vitor Gaspar, Hans Joachim Klöckers, Julian von Landesberger, Klaus Masuch, Wolfgang Modery, Wolfgang Schill and Volker Wieland, and also Ludger Schuknecht for individual chapters. Lars Svensson and John Taylor were kind enough to comment on passages relating to the choice of monetary policy strategy. Not least, five anonymous referees encouraged me in my project and at the same time made numerous suggestions, many of which I

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have followed. Wolfgang Modery took care of the figures and tables. My assistant Marcel Bluhm was an indispensable aid to me on all technical matters. Birgit Pässler untiringly transposed my manuscript into readable text. Chris Harrison guided the publication process at Cambridge University Press, and kindly offered to take charge of preparing the index.

In Nigel Hulbert I found the ideal German–English translator, and I am also grateful to him for a number of valuable suggestions concerning the text.

I dedicate this English-language version to my colleagues at the European Central Bank as an expression of my gratitude for their outstanding collaboration over the years.

Otmar Issing