Ceremony in honour of Prof. Dr. Dr. h. c. mult. Otmar Issing, President of the CFS

4 May 2016, Goethe University Frankfurt

On 4 May 2016, the CFS was hosting the Ceremony in honour of Professor Issing’s 80th birthday. Over 400 high-ranking guests from academia, politics and the finance industry participated in the event. The Ceremony focused on a special lecture, held by Mervyn King, former Governor of the Bank of England. Furthermore, Mario Monti, former Prime Minister of Italy, Rolf-E. Breuer, former Spokesman of the Board of Deutsche Bank AG and Jan P. Krahnen, CFS Director, contributed speeches.

Dr. Breuer opened the event and welcomed the speakers and the audience in Frankfurt. Breuer emphasized that Issing’s career was and is dedicated to the euro as a key aspect of his work. Issing was instrumental involved in setting up the European Central Bank and ensuring that it becomes the today’s worldwide highly respected institution. “His life and work is permanently connected to the beginning and the first years of the euro”, so Breuer further.

In his laudation, Professor Krahnen honoured Issing as an outstanding builder of bridges between disciplines within academia, between academia and politics and connecting both to the general public. “If it comes to the core of his economic convictions, Otmar is absolutely principled, and his voice is widely heard in Germany exactly for that reason. His credibility, his reputation, and his unique background as one among the very small number of de-facto chief architects of Europe’s new monetary order has if anything, increased over the past couple of years,” stated Krahnen.

In his ceremony lecture “Challenges for central banks: lessons from Issing” Lord King talked about three lessons that he has drawn from Issings’s writings and public service. They relate to:

(i) The problematic nature of fixed exchange rate regimes;

(ii) The centrality of price stability to monetary policy;

(iii) The dangers of a centralised state imposed without a democratic mandate in order to rescue monetary union in Europe.

Fixed Exchange Rate Regimes

King spoke about how he first met Issing in 1992, when he was the Chief Economist at the Bank of England and had been sent to the Bundesbank to explain why DM2.95 was exactly the right exchange rate for sterling as the UK struggled to stay in the ill-fated European Exchange Rate Mechanism (ERM).

“This was an act of duty rather than of intellectual conviction. Fixed exchange rates were never likely to provide a stable framework for a monetary regime when countries experienced very different shocks” King explained and added further: “Deep down we knew that the real choice was between floating exchange rates or a monetary union”. However, King’s duty was to persuade Issing that sterling was fairly valued and that Germany should help to keep sterling within the ERM. No number of coloured charts could conceal the fact that neither Issing nor King felt that there was anything the Bundesbank could or should do. Markets believed that the British Government would choose to
withdraw from the ERM rather than raise interest rates to whatever level it might take to stay in the Mechanism. “And they were right”, so Kings further: “Two days later, sterling crashed out of the ERM. The lesson of 1992 was clear. Fixed exchange rates were problematic. The choice was between floating rates, as chosen by the UK, and monetary union, adopted by Germany and its partners.” “Despite the damage done to Britain’s credibility in monetary matters, a deep and lasting friendship (...) was born and continues to this day”, King reflected.

**Price Stability and the Role of Monetary Policy**

According to King, it was Issing who introduced him more deeply to the problem of Price Stability. After the painful experience of high and volatile inflation during the 1970s and 1980s Britain too was led to the point where it put price stability at the heart of monetary policy-making. These similarities between the central banks were what he and Professor Issing were discussing. What is more, King also stressed, is the importance of monetary policy judgment, which should not be replaced by forecasting a precise path for interest rates. Monetary policy cannot be the mechanical implementation of a rule, but neither the subject of absolute discretion. What is crucial here is the formal commitment to price stability. King pointed out that the economic models “ignore the possibility that all of us (...) change our view as to future prospects resulting in the need for a shift to a new equilibrium of the real economy”. Hence, King recalled that Issing “has always argued there is no substitute for serious thinking about what is happening in the economy and how best to respond to unexpected events”.

**The Future of Monetary Union in Europe**

The final argument presented by King was the future of the Monetary Union which in his opinion faces now existential problems. This is so as due to the failure of some member countries to maintain competitive, the euro area is now confronted with the choice of pursuing one, or some combination, of four ways forward: continue with high unemployment in the periphery countries until wages and prices have fallen by enough to restore the loss in competitiveness; a period of high inflation in Germany and other surplus countries, while restraining wages and prices in the periphery; accept the need indefinitely for explicit transfers from the north to the south to finance the full-employment trade deficits in the periphery countries; and change the composition of the membership of the euro area none of which is acceptable by all of the countries.

Further, King recalled the word of Otmar Issing: “Economically and politically, relaxing the no bail-out clause would open the door for a massive violation of the principle of no taxation without representation, creating strong movement toward a transfer union without democratic legitimacy” what is ignored by the politicians. He then explained that the major problem of the European monetary union is the fact that it is politics based not a constitutional project. With respect to this, according to King, the three lessons that have to be learned from this are firstly that “it is sensible to ensure that all partners in a monetary union have fully converged on the same underlying rates of wage and price inflation before they are permitted to join”. Secondly, after the creation of the union, it is crucial to monitor and prevent any divergences in wage and price inflation. Thirdly, because the economic shocks are unpredictable the monetary union will experience a great strain “unless there is a high degree of mutual trust and willingness to make transfers to countries that have suffered major shocks”. This, however, requires political integration which is what is missing in the present Europe.
Hence, the politicians should listen to what Otmar Issing has to say about the need to base monetary union on political legitimacy, as otherwise “they will find that they may well disappear under the waves of popular discontent” said King. He finished his speech by saying that “we can all draw comfort from the fact that Otmar Issing remains in the prime of life”.

Following Lord King’s speech, Senator Mario Monti, who has known Issing since the early nineties, expressed his greetings. Being attracted to a monetary policy approach pursuing price stability over the longer term, not short-term activism; targeting monetary aggregates rather than interest rates; and conducted by an independent central bank, both gentlemen developed a friendship lasting to this day. Monti reminded that Issing will be forever linked to the conception, birth and infancy of the euro and remaining faithful, not only to a number of sound economic principles, but to the tendency to look at the ethical underpinnings of economic arguments.

The ceremony ended with final words by Otmar Issing. He expressed his gratitude to the speakers and the CFS team and thanked his colleagues from universities, from central banks (Bundesbank, European Central Bank, other central banks), from the financial industry and the media for joining the event.