EVENT SUMMARY

The Sixth Annual Whitman Lecture: “The Euro—A Stable Currency without a State”

Professor Otmar Issing

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Otmar Issing: European Monetary Integration Fostered Political Cooperation

A former member of the executive board of the European Central Bank (ECB), professor Otmar Issing of Germany detailed the history of the European Union, arguing that the emergence of European monetary cooperation was the only effective means by which Europe could have integrated itself politically after World War II.

The concept of European economic integration took hold after 1945, as Europe, weary from three decades of conflict, was eager to prevent another continent-wide war. Founded in 1949, the Council of Europe represented this desire for unity but lacked cohesion and clarity of purpose. In contrast, the coal and steel agreement between France and Germany proposed by French foreign minister Robert Schuman in 1950 in order to make war “materially impossible” effectively promoted reconciliation between the parties. The small two-nation nucleus of countries at the center and the concrete economic purpose of the agreement were keys to its successful proliferation. Meanwhile, the step-by-step process by which the eurozone expanded allowed this cohesion to hold for decades.

Three good strategic decisions aided the European Union. First, economic means were used to accomplish political ends. Second, deep political integration was achieved through holistic rather than sectoral economic integration. Third, Europe avoided adopting a supranational political authority as it was forming a common market. In keeping with the apolitical nature of the Union, the European Central Bank has clearly indicated that its monetary policy is not intended to augment or diminish the international role of the euro, which is instead determined by the market. This principle is essential; to undermine it would be to undermine integration itself. In the absence of the strife that would have been caused by a common political authority, nations gave up the significant power of monetary sovereignty, and their people slowly began to identify as Europeans.

The Stability and Growth Pact keeps changes in aggregate budget deficit in line with the common monetary policy. The Pact is the “knife edge” that makes common currency possible without a common government. It is not clear, however, that the Pact has enough teeth to enact and enforce sanctions against large countries. Neither is it clear that countries with historically high inflation and current account deficits have sufficient political will to maintain tight monetary policy after accession to the European Union. Nevertheless, erosion of fiscal sovereignty would create tension and undo political union. In order to keep the European Union successful, the Stability and Growth Pact must be observed independently.

The politically decentralized nature of the European Union makes handling of the current financial crisis difficult in some ways. One difficulty is that no central institution has the authority to inject capital into the European economy, that power being left up to individual finance ministers who must coordinate independently from the EU framework. The crisis has led to calls for harmonization of social security programs and tightening of labor market rigidities. Such actions would only harm growth and undermine union.

Question and Answer Session

During the question and answer session, Anders Åslund asked whether the current financial crisis constituted an extraordinary enough circumstance for countries to be relieved of Stability and Growth Pact obligations. Another audience member wondered whether integration could be considered successful when European growth has lagged behind that of the United States and Europe was the first to fall victim to the financial crisis. Adam Posen asked whether Europe should rethink accelerating the accession of small countries into the European Union, given that one of the major benefits of the eurozone is that it protects small countries from speculation, and pointed out that capital has flowed into US Treasury bills in the past two months. Fred Bergsten wished to clarify whether the tradeoff of joining the eurozone was to reduce the risk of crisis in return for slower growth due to lack of individual monetary authority. Marc-Olivier Strauss-Kahn asked whether the euro prevented measures that could have alleviated markets during the crisis and wondered how far Europe could go to contribute to individual monetary stability. Ted Truman questioned whether the lack of a European lender of last resort would prove to be an issue during the crisis.

Issing responded that governments can and should find a way to keep the Stability and Growth Pact rules intact. Admitting that studies cannot find a positive (or negative) effect of integration on growth, he maintained that economic growth is a poor measure of the European Union's success. The test is whether Europe is better off with the euro than it would have been without it. If there were no common currency, the financial crisis would have been much worse due to speculation. Issing explained that capital was flowing toward T-bills due to repatriation of American money and maintained that countries must prepare to join the European Union by meeting inflation and current account standards. He warned that a policy aimed at becoming an international currency would be unstable. Finally, Issing denied that a lack of a lender of last resort would pose a problem, arguing that individual finance ministers' sole authority to invest taxpayer money is the real issue. Unfortunately, coordination on spending is politically possible only during a crisis; it is impossible to accomplish ahead of time.