

Otmar Issing

Why am I speaking here? There is a simple answer to this question:

Otmar Issing asked me to do so.

Yet why did he ask me? That is less obvious: I have never been his colleague; I am neither a distinguished monetary economist nor a central banker; I am sceptical about the wisdom of the project on whose construction he has been engaged; I am dubious about aspects of the wider European project, of which the European Central Bank is so significant a part; and I have even been a not infrequent critic of the decisions of the ECB itself, of which he has been the guiding spirit.

Nothing, in short, made it at likely that I would delight this distinguished audience with a panegyric worthy either of the occasion or of the man.

But the very fact that I have been invited is a sign of why Otmar is worthy of praise. I am here because, as he told me, he desired not the eulogy customary on these occasions, but rather an outsider's view of central banks, in general, and his central bank, in particular.

How then do I view central banks, this particular central bank and Otmar Issing?

In trying to answer these questions, I found guidance in five quotes: one profound, one sceptical; one pragmatic; one classic; and one humorous.

First, there is the profound, from Ludwig von Mises in 1912: “it is impossible to grasp the meaning of the idea of sound money if one does not realize that it was devised as an instrument for the protection of civil liberties against despotic inroads on the part of governments.

Ideologically it belongs in the same class with political constitutions and bills of right.”

Second, there is the sceptical, from the great American economist, Irving Fisher, this time in 1911: “irredeemable paper money has almost invariably proved a curse to the country employing it.”

Third, there is the pragmatic from that most pragmatic of Englishmen, Eddie George, former governor of the Bank of England, this time in 1995: “central banks don’t have divine wisdom. They try to do the best analysis they can and must be prepared to stand or fall by the quality of that analysis.”

Fourth, there is the classic, from William McChesney Martin Jr, chairman of the Federal Reserve from 1951 to 1970: "The job of the Federal Reserve is to take away the punch bowl just when the party starts getting interesting."

Finally, there is the humorous, from Will Rogers, a well-known American wit, cited by Paul Samuelson: “there have been three great

inventions since the beginning of time: fire, the wheel, and central banking”.

So how do I see contemporary central banks? I see them as institutions that: understand what von Mises said, try to prove Fisher wrong, fall prey to the ignorance of which Eddie George spoke, try to cut back when everything is still going fine, as McChesney Martin recommended, and recognise that, important though they may be, they are not in charge of the world’s third most important invention. Humanity’s third most important invention is writing. This is why I, a professional writer, believe I am entitled to assess the contribution of those who are responsible for only the fourth. Without money there can be no complex division of labour; but without writing there is no civilisation.

Why did I start with these quotations? The answer is that Otmar, a German liberal in the tradition of Walter Eucken and Ludwig Erhard, believes in the constitutional role of sound money, fears the social calamities visited by monetary mismanagement and is ideally suited to the role of conservative central banker outlined by McChesney Martin. For these reasons, he has also been precisely the right person to provide intellectual guidance to a new central bank for a continent struggling to heal the scars of past disorder, including, not least, monetary disorder.

These have been serious tasks for a serious man. And such a man deserves a serious speech.

With brief and partial interruptions, we have lived in the era of fiat money since Europe embarked on suicide, in the first world war. But only over the past two and a half decades have monetary authorities done a passable job of proving that Fisher might be wrong. Prior to this, we witnessed one monetary calamity after another: the hyperinflations of the early 1920s; the great depression; and then a worldwide inflation in the 1970s. For all of these central bankers bear at least part of the blame.

So my most fundamental response to the question Otmar set me is this: central banks are trying to prove that we can manage money wisely in a world that has discarded the constraints of what J.M. Keynes called the “barbarous relic” of metallic money. Keynes’ fault was his belief that people like him could – and would be allowed to - manage our world, instead. For about 25 years central bankers have indeed operated like Platonic philosopher kings. Will they be allowed – or be able – to continue to do so.

Now let me turn to a second response. In a world of pervasive uncertainty, institutional evolution and so trial and error have great value. That was Hayek’s greatest insight. While we have a reasonable understanding of what central banks should be doing, there is much we

do not know: we do not know how far central banks should attempt short-term macroeconomic stabilisation; we do not know how much risk they should take in judging the natural rate of unemployment; we do not know what attention they should pay to asset prices in forming monetary policy; we do not know whether data on the money stock give useful information; we do not know the ideal time horizon for monetary policy decisions; we do not know whether it makes sense to indicate the future course of a central bank's monetary decisions; and we do not know whether central bank should be responsible for the systemic stability of the financial system.

Since there remains so much we do not know, it is immensely valuable to have a set of competent central banks implementing somewhat different answers to these questions. Let a thousand – or at least three of four - flowers bloom and our experience be the judge.

This then is my second response to Otmar's question: let the best central bank – or rather the practices of the best central bank – win. That is what the Bundesbank achieved not just inside Europe, but in the wider world. We are now in a second such competition, one in which the ECB has a distinctive position. It is a position with which I am not altogether in sympathy. But it is immensely valuable for our collective future that this experiment exists.

My third response is that central banks remain highly political institutions. The ECB, in particular, is an expression of specifically European politics, both in its independence from politicians and in its political isolation. This is a blessing and a curse: it is a blessing because the ECB can do what it wants; and it is a curse, because it is a whipping boy for populist politicians.

In their wisdom, or rather lack of it, European politicians decided to create a monetary union without a labour market capable of adapting to its rigours. They agreed to fiscal disciplines, but discarded these when the rules started to bite. They agreed to a project requiring the highest political commitment and then indulged in a flood of anti-European rhetoric, thereby laying the ground for the rejection of the constitution that manifested such a commitment. They still make the fiscal decisions on which the stability of fiat money ultimately depends. Not least, they are able to blame the ECB for what is going on inside their country, thereby undermining the population's commitment to European integration itself. All central banking is politically tricky. The ECB's is surely trickiest of all.

My fourth response is that the UK would have been a particularly badly behaved eurosceptic cuckoo in the nest. It is a huge blessing that the UK has stayed outside. It is good for the UK that it is responsible for its own

monetary fate. It is good for Europe that it does not have British disruption to add to those more than adequately supplied by other big member states.

I said at the beginning that I would discuss central banks, the ECB and Otmar, in that order. Having said what I can about the fragile achievements of - and perils confronting - the first two, let me turn to the contribution of the last. The challenge confronting the ECB during the first six years of its existence has been to take up the mantle of the Bundesbank, the most complete embodiment of von Mises' constitutional perspective and Europe's most successful central bank. If that mantle could not be worthily worn by the ECB, this project would have foundered. Otmar's job was to ensure it was. It is why he was here. It is also exactly what he has achieved.

As an outsider whose job was defined by a pre-war British politician as "power without responsibility – the privilege of the harlot throughout the ages", I recognise and respect a man who has carried out such a task. I admire Otmar's ability to bear his historic responsibility lightly. I do not know whether the achievements of modern central banks will prove lasting. I do not know whether the euro will be deemed a success in the distant future. But I do know that Otmar Issing has done his best to bring

the legacy of the Bundesbank to the ECB. The economist as commentator salutes the economist as practitioner for a job well done.