Guardian

9/22/92



The Bundesbank was only obeying orders: **Josef Joffe** on the view from Munich

# The market über alles

JUST before the French referendum Chancellor Kohl dispatched his favourite metaphor across the Rhine. "The train bound for Europe," he warned the French people, "must not be stopped." The French just about cleared the tracks, but, alas, Helmut Kohl's Eurotrain *has* stopped. In fact, it was derailed last Wednesday when a monetary earthquake hit Europe from which it will not soon recover.

That is why the feeble French Oui hardly matters. A common European monetary policy, "ultimately including a single currency," as page one of the compact has it, is the heart of the Maastricht treaty. That heart has stopped beating. It has been rent asunder by those pesky economic realities that democratic leaders love to ignore. Would that Messrs Kohl, Mitterrand and the whole lot had read an introductory economics textbook before ramming the treaty through far from the eyes of their electorates. Then they would have learned that you cannot put the proverbial cart before the horse.

They thought that monetary unity could go first and that economic policy would follow. That myth, threadbare to begin with, was exploded last Wednesday when Britain and Italy, bloodied and humiliated, pulled out of the straitjacket called ERM.

There are two morals to this battle along Europe's monetary Maginot lines — one technical, the other political. The technical lesson is this: don't try to fool the markets. When economies and economic policies diverge, the currency bond must and will break. Unless we all have more or less similar incomes and monetary policies, unless our inflation and interest rates move more or less in tandem, we will fail to keep parities in lockstep.

To be sure, when Helmut Schmidt and President Giscard d'Estaing designed the straitjacket back in 1979 they thought that bondage would breed discipline. Faced with the pain of devaluation, Europe's fiscal junkies would come clean and mend their profligate ways. Wrong.

If you look at the history of this institution you will note that until 1987, realignments were almost routine. Nations went on behaving as nations always do. Their leaders looked first at their unemployment rates, then at their electoral calendars. And then they wriggled out of the straitjacket, leaving the markets in charge of setting parities.

This is why ERM survived so long, instilling the comfortable belief that somehow we were all happily moving forward into that wondrous land of monetary union. But five years ago, the time bomb began to tick: when holding the Maginot line became a matter of unbreakable national pride. No more realignments was the pledge, and this is why the markets took such horrible revenge on Messrs Major and Amato.

The political lesson is just as harsh: don't put the junkie in charge of the drug supply. Here, too, a bit of history will clear the mind. Originally, (West) Germany, given as always to discipline *uber alles*, was to play the taskmaster, cracking the whip over the wayward and, by yanking the parity chain, force them back into fiscal probity.

But that was yesterday, before the fateful take-over of Prusso-Marx by Bonn Inc in 1990. In the meantime, the disciplinarian had turned into a spendthrift. The bill of reunification runs to about DM 200 billion per annum, but that money does not come out of higher taxes or lower expenditures. This year, the federal government, the Länder and the local authorities will rack up DM 170 billion in new debt.

Again, the textbooks ought to have been consulted. That kind of deficit-spending *has* to fuel inflation, and where there is inflation, the dour-faced governors of the Bundesbank put on their helmets. Their legal brief is to uphold the "stability of the currency," and that they did with a vengeance.

Hence, interest rates rocketed sky-high, and since everybody is chained to the almighty Deutschmark, it was only a matter of time before disaster struck. Let's not be too harsh on the Bundesbank. It only followed orders, as laid down in its charter. And when pound and lira began to burn, the Bundesbank desperately tried to douse the flames by injecting some DM 60 billion into the markets to uphold the value of the weaker currencies. To no avail, because in the end, you can't fool the markets. Q.E.D.

But markets are not governed by invisible hands. The Bundesbank did what it had to do because the fire had started elsewhere: in the chambers of the Bonn government which thought — as do all democratic leaders these days, Bush, Kohl et al — that you can have your cake and eat it. Or rather, that fiscal pain can be postponed to the day after tomorrow — when the next generation has to pay back what we spend today.

WHAT future, then, has Herr Kohl's Eurotrain? To begin with, we should all accept that it has been derailed, at least in its Maastricht version. There will be no common currency for a long time to come, not until we have put all our little national trains on to parallel tracks.

But all is not lost if we allow realism to gain the upper hand. Maastricht or not, the single market will kick in on New Years's Day 1993. Given the inevitable upheavals that Big Bang '93 will create, the demise of the ERM might actually be a blessing in disguise. For a bit of national monetary freedom might help us cushion the nasty shocks of market unification. A single market without a single currency spells frictions — but none that industry has not learned long ago to handle. It is time to let the markets do their work and integrate outside the monetary straitjacket. When the single market is in place, let's try again to cobble together a common currency. The market will have to come first, the money will follow.

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