

## OTMAR ISSING

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*Otmar Issing is one of the personalities, who played a role not only in the*



*theory of money, but above all in the area of practical monetary policy.*

*Otmar Issing was born in 1936 at Würzburg, got married in 1960 and has two children. After passing his final examinations at the Humanist Gymnasium in his native city, he began to study ancient philology in 1954, but after a year of study he transferred to study of national economics at the University of Würzburg, which he successfully completed. Immediately after graduating, he started work as an assistant in the Department of National Economic Theory and Social Sciences in the University of Würzburg, where he gained a doctorate in 1961 and qualified as a senior lecturer in 1965. In 1973, he left his position as professor and head of the Department of*

*International Economic Relations at the Economic and Social Faculty of the University of Erlangen – Nuremberg to return to the University of Würzburg as professor of national economic theory. By the end of the eighties,*

*Otmar Issing began to orient himself increasingly towards practical activity in economics. In 1988 – 1990, he was a member of the Council of Experts for Assessment of Macroeconomic Development, and in 1990 he finally became a member of the Board of Directors of the German Federal Bank. From the origin of the European Central Bank in 1998, he was a member of its board of directors and its chief economist.*

**Otmar Issing** is the author of two standard textbooks: Introduction to Monetary Theory (Einführung in die Geldtheorie) published for the 12th time in 2001 and Introduction to Monetary Policy (Einführung in die Geldpolitik) published six times up to 1996. Both textbooks are standard works for students in the economic faculties of German universities. It is worth mentioning that both textbooks have been translated into Chinese and the first also into Bulgarian.

Apart from these textbooks O. Issing has published a large number of independent works and articles expressing views on topical problems connected with monetary policy. Many of these works concern the common European currency, which was written about by O. Issing as early as 1988, long before Maastricht.

O. Issing started his textbook on monetary policy with consideration of the essence and functions of money and about different understandings of the quantity of money in the economy (Geldmenge) up to the present conception of the European Central Bank. He devoted a further chapter to demand for money, essentially starting from Friedman's conception, which he confronts with the Keynesian approach. He devoted considerable attention to the influence of the price level on demand for money, stating that when higher prices are expected, economic entities reduce their demand for money. Interest rates and expectations concerning the further development of prices influence the alternative costs (Opportunitätskosten) of the holding of money. In the extreme case of unlimited interest rate elasticity and

zero income elasticity, the so-called liquidity trap arises and monetary policy is ineffective. Stable demand for money becomes unstable when the central bank attempts to use these relations to direct monetary aggregates and so violates the trustworthiness of monetary policy. O. Issing also considers the stability of European monetary aggregates and comes to the conclusion that income elasticity is definitely positive and this is also true of property effects.

Otmar Issing states in his consideration of money supply that it is formed by the money of the central bank (Zentralbankgeld) and the money of the commercial banks. He also makes some critical comments on the conception of the monetary multiplier and he researches the influence of the financial market on the money supply. The market interest rate and the quantity of money are determined simultaneously. Inter-bank loans increase the elasticity of the financial system. O. Issing has devoted two monographs to this problem: Zur Rolle der Interbankbeziehungen from 1977 and Die Geldmengenstrategie der DBR from 1995.

O. Issing mentions all the more important conceptions in his considerations of the theory of interest rates. He devotes considerable attention to the IS-LM model, in which he especially criticises only the limited development of the supply side, which does not take into account changes in the relative prices of goods and so regards the level of prices as independent of changes in the quantity of money. However, in spite of this, he recognises the analytic importance of this model. He



also devotes attention to the influence of the quantity of money and income, which, in the end, increase interest rates. He considers in detail the theories of the structure of interest rates.

O. Issing begins his considerations of the national economic connections of money with a description of the theory and its development. Empirical evidence confirms the correctness of the quantitative theory and shows a clear connection between the quantity of money and the level of prices, while interest rates have little influence. The extreme growth of prices has significant influence on the rapidity of the circulation of money. Aggregated demand for money grows or declines in relation to the movement of prices, while the aggregated supply of money is a function of employment and the amount of capital, which determine real wages and production. Interest rates are independent of the nominal quantity of money. Money itself is neutral, but ceases to be neutral at fixed prices.

O. Issing devotes considerable attention to the problem of liquidity with the theory of the liquidity of money replacing the concept of money and the problem of the substitutes for money. If the mediators of loans really have as much influence as the theory claims, there is no such thing as a stable function of demand for money – with all the results for monetary policy. Only empirical research can verify the correctness of this claim.

In connection with inflation, O. Issing devotes his attention especially to the relations between inflation, employment and economic growth, after clarifying the basic concepts. Empirical research shows that in the medium term there is no stable relationship between inflation and unemployment. The policy of reducing inflation after 1980 caused increased unemployment almost everywhere. The development was cyclical in the USA and unemployment fell with a stable level of inflation. The development in West Germany was very interesting. There were stable prices with full employment in the 1960s, but in later decades the development of these indicators was very varied and unpredictable.

One of the most controversial problems of economic science is the relationship between inflation and economic growth. The thesis of a positive influence of moderate inflation on economic growth is justified by the pressure of demand, lagging of the growth of wages behind investment and the development of real interest rates. According to Mundell, real interest rates also decline in the event of fully anticipated inflation, but this is not empirically proved. Inflation always has significant effects on the distribution of income, benefiting owners of assets and debtors. Issing also devotes attention to the influence of the profit, which the central bank gains from the fact that the money of the central bank is not

subject to interest (seigniorage or monetary monopoly). According to Friedman, constant deflation secured by a zero nominal interest rate is necessary to balance this influence. According to Phelps, moderate inflation is required.

O. Issing devotes the final part of his book to the process of disinflation and zero inflation. Disinflation or reduction of inflation causes decline of output and employment. A more extensive work of Issing, *The Macroeconomics of Low Inflation* from 1996, is devoted to this problem.

### Issing and monetary policy

Issing's textbook on monetary policy, one of the first systematic textbooks on this problem, may have even greater importance than his textbook on monetary theory. Issing begins by dealing with the term monetary policy. He distinguishes the term „Währungspolitik“ as a broader term and „Geldpolitik“ as a narrower term directed only to the monetary relations within a state, but he casts doubt on this distinction. (In Slovak the unified term „menová politika“ or „monetárna politika“ is normally used). Then he describes the individual monetary systems and the role of the central bank (in German „Notenbank“), the development of the monetary system in the Federal Republic of Germany and international financial markets. He deals in great detail with the individual instruments of monetary policy, which leads to a description of the instruments of monetary policy of the European Central Bank. Issing gives an interesting account of the policy of obligatory reserves with a detailed analysis of the advantages and disadvantages of this policy and about selective monetary policy, which is differentiated according to different branches or groups of enterprises by the use of instruments. While examining the transmission mechanism of monetary policy, O. Issing points to the different approaches of Keynes and the monetarists, and to the method of adaptation of the banking and non-banking sector, including the delayed effect of monetary policy. He is also concerned with the possible aims of monetary policy. The final aim of monetary policy is always growth of the national economy, but the central bank cannot influence this directly. Therefore, it selects intermediate aims, which may concern either the development of monetary aggregates, liquidity, interest rates or directly inflation. Financial innovations, which lead to the origin of new monetary substitutes, may have a significant influence on selection of the correct aim of monetary policy.

Issing deals in great detail with the relationship between monetary and fiscal policy, taking a generally



sceptical view of the effectiveness of fiscal policy. While examining the problem of monetary policy in an open economy, he especially notes the influence of fixed and moveable exchange rates on the monetary situation within a state. He also points to the limited possibilities of monetary policy to effectively compensate for the influence of exchange rates on the domestic economy. Monetary policy should start from a longer-term orientation, which leads to more realistic expectations by actors in the financial markets. The concluding considerations of O. Issing about the strategy of monetary policy, that is, the choice of appropriate intermediate aims and instruments, are very interesting. His considerations lead to a demand for a stable and trustworthy monetary policy, which can be regarded as the main conclusion of all his publishing activity. Even if Issing

had written only these two textbooks, he would have a place among the key authors in the area of monetary theory and policy. However, Issing was never only a theorist, but was always concerned with the topical problems of monetary policy. This was already the case when he worked as a university teacher, but applied especially from when he began to work on monetary policy also in practice. He was well prepared to deal with a huge number of questions, which cannot be mentioned here for reasons of space. It may be interesting for us that he has expressed certain doubts about the efforts of various future members of the EU to achieve early entry into economic and monetary union. Otmar Issing is an important example of the combination of a highly erudite theorist and a practical maker of economic policy.