

Duisenberg steps down

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Wim Duisenberg, the controversial president of the European Central Bank, has announced that he will step down early, in July next year. His departure could mean a protracted struggle for the presidency: but it is unlikely to have much short-term impact on the anaemic euro which has been caught, once more, in the wake of the dollar's surge. Does the weakness of the single European currency matter?

Reuters



Duisenberg tries to get his message across

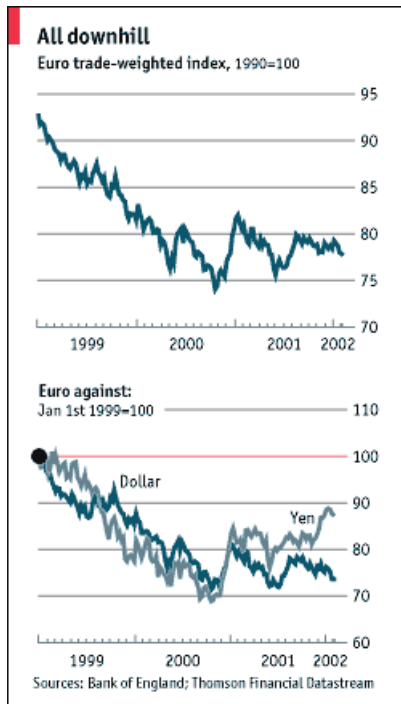
WIM DUSENBERG has certainly been a colourful first president of the European Central Bank (ECB). His critics have often been contemptuous, regarding him as tactless and even incompetent. More than one commentator has noted that running Dutch monetary policy used simply to be a matter of picking up the telephone and taking orders from the German Bundesbank: hardly good preparation for taking charge of monetary policy for the whole euro area. Since the euro came into being in 1999, Mr Duisenberg has not only presided over the ECB but over what many people have seen as a calamitous fall in the new currency's value and an interest-rate policy which some have blamed for Europe's sluggish economic performance.

So one might reasonably have expected that the announcement, on February 7th, that Mr Duisenberg would step down early from his job would be greeted with sighs of relief. In some quarters it will. Mr Duisenberg is leaving in July next year, some five years into his eight-year term of office. But the question of the succession is likely to be as protracted and complicated as his appointment in 1998.

It is widely believed that Mr Duisenberg got the job as part of a backroom deal for which the French president, Jacques Chirac, was the principal instigator. Mr Chirac wanted a Frenchman, specifically Jean-Claude Trichet, governor of the Bank of France, to have the job. But Germany and other countries balked. A compromise was reached. Mr Duisenberg won the appointment but allegedly agreed to step down half-way through his term, to be replaced by Mr Trichet. Once in the job, Mr Duisenberg appeared to repudiate the secret deal, though he did say that in view of his age he did not expect to serve a full term.

There is little prospect of a smooth transition, however, because, apart from anything else, Mr Trichet is caught up in lengthy legal investigations into scandals at a large French bank, Credit Lyonnais: questions have been raised about Mr Trichet's role in the affair. Unless he has succeeds in clearing his name, it seems unlikely that other euro-area governments will approve his appointment as the ECB's head.

There is, therefore, likely to be a long period of uncertainty about Mr Duisenberg's successor. Will this harm the euro's prospects? It certainly can not help. Since January 1999 it has consistently under-performed expectations about its value in relation to the American dollar and, to a lesser extent, the Japanese yen. Recent weeks have seen another bout of euro-anxiety.



Since the beginning of the year the euro has once again seen its value against the dollar fall. This has been a disappointment to those who see the currency's external value as somehow symbolic of Europe's economic strength and who had hoped that the introduction of euro notes and coins on January 1st would somehow transform the new currency's fortunes.

And yet things may not be as bad as they appear. As often happens with discussions about exchange rates, too much emphasis can be placed on short-term fluctuations. Such debates are also prone to exaggeration. The euro has lost about 3-4% of its value against the dollar in the past month. It may yet lose more. But so far it remains above the lowest point it has reached in the past six months; and it is still significantly higher than its all-time low, reached in October 2000. And while in the short term it would be a mistake to attribute too much economic wisdom to the foreign-exchange markets, it is not difficult to find reasonable expectations for the euro's decline.

Foremost is the judgment of many economists that America is now poised for recovery from recession and, if the trends seen in the latest data are confirmed, to do so more quickly than many people had anticipated. Of all the world's rich economies, America has persistently proved the most dynamic and resilient; and nothing that has happened during the current global downturn seems to contradict that. It is, of course, possible that the optimists are taking too rosy a view of American prospects: although the Federal Reserve decided against another cut in interest rates last week, it sounded a note of caution, talking about the continuing risk of economic weakness.

But the euro-area's performance has given much greater cause for concern. Most economists reckon Germany—the world's third-largest economy, and the euro zone's biggest—is in recession. The German downturn, moreover, came after a relatively brief and half-hearted upturn, especially when compared with the longest peacetime expansion in American history. The euro area's lacklustre economic performance has disappointed many of those who had detected signs of a stronger commitment to reform, especially in Europe's traditionally rigid labour markets. In the event, reform has been slow to materialise and most euro-area economies have a long way to go before their labour markets are as flexible as those in America, or even Britain. Plans to dismantle state-run monopolies and to open Europe's markets to greater competition are also taking much longer to push through than previously seemed likely.



Seen in this light, the relative weakness of the euro is helpful for the euro-zone economies. The lower the value of the euro, the more competitive are euro-area exports to the rest of the world. Indeed, some big American manufacturers have recently begun to complain about the strength of the dollar, both in relation to the euro and to the yen: they are finding it harder to compete in world markets.

Indeed, it is possible to argue that the euro's continuing weakness is at least partly an inevitable reflection of the dollar's strength. The American currency has consistently defied predictions of impending collapse. It remains the currency of choice in times of trouble, as its sharp appreciation since the war on terror that began after the events of September 11th last year has shown.

The good news for European exporters is that the American government shows no sign of seeking to push the dollar down. There is great scepticism in Washington about the idea of exchange-rate co-ordination (a tactic much favoured in the 1980s, for example). Paul O'Neill, the treasury secretary, said recently that he had no sympathy for American manufacturers who lobby against a strong dollar. Good companies, he argued, do not live or die on exchange rates.

Because the dollar is still the world's principal reserve currency—there are large holdings of dollars outside America—any pronounced and prolonged decline in its value ultimately depends on there being attractive alternative assets for people to hold. Many Europeans—or at least European leaders—had hoped that the euro would assume this role. For some, it was a matter of pride, which the new currency's weakness has bruised. In fact, the figures show an increasing number of private-sector bond issues are denominated in euros, for example.

But it takes time for a currency to build up reserve status. And it is not only the disappointing economic performance of the euro area as a whole that has deterred investors. Under Mr Duisenberg, the ECB has, to some extent, undermined confidence in the single currency. This is not because of a widespread belief that the bank has, so far, made major policy errors—though many economists think it could perhaps have moved more swiftly to cut interest rates last year when the extent of Germany's economic problems started to become clear.

Fixing the ECB

More troubling is the structure and operation of the ECB. Compared with other central banks, it is thought to lack transparency—it does not publish records of its meetings, for example. The decision-making framework puts too much reliance on low inflation and, in particular, too much emphasis on undershooting the inflation target which the bank sets for itself. In public relations terms, the ECB has spectacularly failed to get its message across. Too many of its members are too loquacious, speaking publicly despite the market sensitivity to anything they say, and often saying different things. Mr Duisenberg, it has to be said, is a prime culprit: he has, in the past, been incautious in his own remarks, and he has failed to control his colleagues, either because he does not think it important to do so or because he can't.

A new president might do better. But more fundamental change may be needed. The European Commission is expected to propose reforms in the bank's structure, probably some time this year. This may, eventually, increase international confidence in the euro. Improved economic performance might also help. And that much-talked-about reversal in the dollar's fortunes might then take place. Changes in the international perception of currencies can take place suddenly. But it might be unwise to bet on a sudden and prolonged upturn in the euro's value just yet.