In what follows, Bundesbank spokesperson Michael Best responds to Maurizio Ferrera's article "The Germanization of Europe", published in our Focus section on 7 July 2016. The opinions expressed in this article are personal and should not be taken as the official position of the Bundesbank. A rejoinder by Ferrera appears at the end of the article.

Not yet a true family – A response to Ferrera

Michael Best

I would very much like to pick up the image of Europe as a "family" and also share my thoughts on Maurizio Ferrera's description of Europe as a "neighbourhood community" as described by Max Weber. It goes without saying that I fully agree that the relationship between the nations and peoples of the member states of the monetary union and the European Union is not one between strangers. Our ties are close—not just because of the treaties, but above all on account of the heritage we share, our European canon of values and the many and varied relationships we all have at a personal level.

An unmistakable feature of a family is that all major economic decisions are taken jointly and that every family member feels bound by those decisions. This image contrasts with the reality of the European monetary union

But allow me to question one particular point made in Ferrera's article: does the use of the term "family" to describe the European Union, and specifically the European monetary union, not oversimplify the complexity of their design? For me, an unmistakable feature—a hallmark, if you will—of a family is that all major economic decisions are taken jointly and that every family member feels bound by those decisions. This image contrasts with the reality of the European monetary union, where decision-making powers are spread across a number of levels. While it is true that the European Central Bank's Governing Council decides jointly on monetary policy matters, there are countless decisions that have a major bearing on economic prosperity which are taken by national governments and parliaments—just take the age of retirement, pension systems, employment protection and the right to go on strike, healthcare and social benefits, government revenue and expenditure, or tax laws and public borrowing. The ability of the public administration to operate effectively, the quality of a country's education system, and the pace at which its courts reach decisions are similarly matters of national responsibility.

How we got where we are

Let us cast our minds back to how this complex setup came into being. Back in 1988, the European Council entrusted a committee chaired by Jacques Delors (the Delors Commission) with the task of exploring the prerequisites for achieving monetary union without political union. The report presented by the Commission in 1989 concluded that a set of binding fiscal and macroeconomic rules and procedures was needed for monetary union to be feasible. Furthermore, deficits and debt had to be curbed, and the monetary financing of the public sector by the central bank prohibited. The economic policies of each member state, moreover, needed to contribute to the success of monetary union. Prominent members of the Commission included Jacques de Larosière, then governor of the Banque de France, Carlo Azeglio Ciampi, governor of the Banca d'Italia, Alexandre Lamfalussy, who later became president of the European Monetary Institute, Willem F. Duisenberg, who later became president of the ECB, and the then Bundesbank president Karl Otto Pöhl. The rules proposed by the Commission, which were later fleshed out in the treaties, were not a German invention but the product of bona fide European teamwork.

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A crucial line of thinking at the time was that a binding set of rules, principally for fiscal matters, combined with prudent and responsible economic policymaking, would prevent crises and emergencies and were the key to not overtax the neighbourhood community, to use the Max Weber term to which Ferrera refers. Solidarity, so the thinking went, would be essentially confined to the EU budget and the assistance it envisaged in achieving economic convergence. Joint liability for government debt was later explicitly ruled out in the treaties, the idea being that this would shield the single monetary policy and encourage national governments and parliaments to honour their fiscal responsibilities in a way that left no doubt as to the sustainability of their government debt.

Regrettably, it later transpired that politicians in certain member states did not act with quite the foresight, prudence and responsibility that the countries had promised each other when monetary union was launched. Three major member states—Germany, France and Italy—were partly to blame for watering down the binding effect of the fiscal rules. This led to a situation where a number of member states were unable to absorb the impact of the global financial crisis without external assistance. Neighbourhood assistance and painful adjustment processes emerged as the only way to restore stability throughout the currency area, with direct financial aid being provided through the European Financial Stability Facility and the European Stability Mechanism.

Cautious Keynesianism

Another question Ferrera raises is whether austerity is a smart economic policy concept. That is not a term I use because, in all honesty, I do not really know what it means. Does austerity mean that borrowing is categorically a wrong economic path to take, or even morally reprehensible? If that is what the term means, then I am most certainly not a proponent of austerity. If austerity is instead defined as meaning that government borrowing should be constrained in such a way that there is still sufficient leeway to combat a crisis, that future generations should not be saddled with excessive interest payments, and that investments should only be funded if they make economic sense, then it is a concept that I could warm to.

Counter-cyclical policy-making needs to be affordable. For that—and other—reasons, I believe that the European fiscal rules make sense.

But if that were the case, I imagine that Ferrera would be hard pressed to find anyone else who is against it. Let me put it this way: I firmly believe that counter-cyclical fiscal policy makes sense—and I guess that makes me a Keynesian, much like many economists these days. That said, I would describe myself as a cautious Keynesian, because counter-cyclical policy-making needs to be affordable. For that—and other—reasons, I believe that the European fiscal rules make sense. After all, if the debt burden spirals ever higher from one cycle to the next, there inevitably comes a point when you have your back to the wall. It is a smart move, I think, to prevent that from happening.

I hope this brief synopsis of my thoughts explains why we insist on agreed ground rules. We do not do that because we love principles for their own sake, but because we believe that a number of principles are sensible and make it easier for us, in the complex institutional setup of monetary union without political union, to raise prosperity for all and to live side by side with as little conflict as possible. One of these principles is the balance of control and liability, or, to put it another way, between decision and liability. Those who call the shots should also carry the can if things go awry. In an ideal world, this fosters good decision-making.

Room for optimism

In closing, let me come back to the relationship between Italy and Germany. I believe in Italy. I am convinced that this country will be strong enough, and committed enough, to overcome its problems. Germany, too, is counting on Italy's ability to successfully resolve the challenges it is facing—indeed, we have problems of our own to tackle—not least because the monetary union has forged such close ties between these two countries.

We are also convinced that lessons from Germany are the last thing Italy needs. Whenever I talk to Italian economists or journalists, I always notice that they know full well what still needs to be done—and much progress has already been made, of course. The quicker and the better Italy manages to transform its own insights into action, the more it will be able to contribute to the success of our common project: economic and monetary union.

Rejoinder: A more effective, impartial and benevolent union

Maurizio Ferrera

The Eurozone does not work like a family: on that I agree with Michael Best. But I disagree on the logic that he sees as the hallmark of families—and, to a large extent, of neighbourhood communities as well. Joint decisions followed by strict individual compliance characterize associations, clubs, formalized economic partnerships and international organizations. Within such contexts, the underlying normative principle is self-interested mutual advantage. Families and in part neighbourhoods are bound instead by reciprocity ties that allow for flexibility, incorporate a degree of mutual benevolence, especially when faced with unexpected emergencies. They rest on the implicit assumption that thick interdependence cannot be managed by formal rules alone, that sometimes compromises have to be made to keep the family together.

Yes, EMU rules were jointly agreed in the early 1990s. But allow me to say that the line of thinking that inspired the EMU architects was somewhat naïve in assuming that fixed numeric criteria would bring about stability and convergence. The politicians who violated the rules in 2003 may have sinned of inadequate foresight, prudence and responsibility. But German authorities had to cope with the largely unexpected burdens of unification and the 9/11 attacks had precipitated a global economic crisis. Building on this experience, the 2005 reform of the Stability and Growth Pact aptly modified the rules to make them less "mechanistic" and to complement the "disciplinarian" Excessive Deficit Procedure with a preventative system of monitoring and warning (the so called Macro-economic Imbalances Procedure). A similar "pendular" momentum has characterized the last five years: first the Fiscal Compact, then the Commission's communication on "flexibility" in the application of numeric rules. I do not regard this regulative pendulum as an indicator of disorder or, worse, moral feebleness and electoral opportunism. Quite to the contrary, I see it as responsible political learning: a process whereby national and supranational institutions adjust their assumptions, goals and values to contextual changes and the consequences of past decisions, based on both economic and political considerations (such as the wish to keep the family or neighbourhood community together).

"Decisions and liability" and "liability only with control" are of course reasonable and largely "healthy" principles, especially in a context in which financial creditworthiness vis-à-vis financial markets must be preserved as a common good within the whole Eurozone. We have to consider, however, that the EMU is not the mere sum of intrinsically determined "parts". It has created a web of interdependences and mutual interpenetrations of domestic economies that make it very difficult (in some cases impossible) to trace the link between institutional decisions (or non-decisions) and their actual consequences. Moreover, a number of key decisions are taken at the supranational level, with momentous consequences for the various member states. Such consequences are not fully predictable ex ante, in neither their substance nor timing. And supranational decisions are sometimes shaped by more or less legitimate interests on the side of political actors. In 2010 Merkel delayed the finalization of the EU response to the sovereign debt crisis because she wanted to wait for the elections in North-Rhine Westphalia. In 2013 she sought, but only partially succeeded, to defer decisions on a European bank resolutions scheme and common deposit insurance till after the September federal elections.

Let me conclude with a point of agreement. Michael Best describes himself as a cautious Keynesian and distances himself from the idea of borrowing as a categorically wrong path to take. I fully subscribe to his suggestion that public investment should be promoted and sustained only if they are productive and in a context of fiscal responsibility (especially vis-à-vis future generations). I would only add a couple of ingredients. Precisely because of thick interdependence and our cognitive limits to identify "liabilities", the euro governance must equip itself with a common budget for responding to asymmetric shocks in speedy, decisive and bold manners. Such budget (or a dedicated fund) should also make sure that no EU citizen is left without adequate livelihoods: the images of destitute Greeks sorting through street garbage containers should be regarded as a common pan-European shame. We certainly cannot do without rules and compliance. Rules must be effective but not impervious to change and flexibility. They should be impartial and fair (and be perceived as such by citizens), resting on both stability and solidarity principles. Finally, mutual advantage and reciprocity should be tempered with some benevolence and compassion for all the "little people" (wherever they live in the EU) who experience undeserved suffering, owing to big economic processes managed by Brussels, far removed from their control.

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