

The appropriate policy mix in the next downturn?

Antti Ronkainen, 5.9.2019

anttironkainen @ twitter

Structure

- The economic framework of the EMU
- The institutional reinterpretation of the EMU's economic framework during the crisis
- Scenarios for the euro forward

The EMU's economic framework

Institutional order

- Bundesbank style ECB
- Monetary financing prohibition (123)
- Rule-based fiscal coordination (SGP)
- No-bailout-clause (125)
→ “market discipline”

Integration

Germany: convergence as a precondition for deeper integration

France: monetary union creates convergence

Maastricht takes French approach to integration with fixed schedule

Institutional response to the euro crisis

Fiscal side

- Reinterpretation of no-bailout-clause (ESM)
 - conditioned for adjustment programs
- Strengthening of fiscal coordination (2&6-pack, fiscal compact)
 - framework ambiguous

Monetary side

- **Starting to act as a lender of last resort (OMT)**
 - conditioned for ESM programs
- **Joining the Fed, BoJ & BoE with QE (APP)**
 - mandate sets technical limits

“Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough.”



- Constitutional battle between the ECB, Germany's Federal Court and the European Court of Justice about the unconventional bond purchases

- Reinterpretation of economic framework:

dampening of market discipline and sound fiscal policies ensured by strengthening fiscal coordination (conditionality & semester)

however rules complex & ECB undermines conditionality

- Absence of fiscal capacity (no euro bonds or budget)

overall firewall around 800 billion

banking union's deposit insurance frozen

The euro crisis as Maastricht II

- Although treaties have not changed, the economic framework has changed
- Fiscally German approach to integration (no fiscal capacity)
- French approach to monetary policy: ECB has abandoned Bundesbank style central banking and increased joint responsibility through interventions
- Unbalanced policy-mix of fiscal and monetary policies
- “Franco-German dual monarchy of multi-speed integration”

Scenarios for the euro

1) Continuation of Franco-German deal

As long as no significant economic convergence and/or substantial fiscal capacity, ECB needs to “preserve the euro” possibly overstepping its mandate

However loose monetary policy can't solve structural problems, decreasing stimulative effect & increasing risks

→ German resistance and involvement of Bundesbank?

2) French approach to fiscal integration?

Using current fiscal leeway to stimulus

Simplifying fiscal rules? Golden rule?

Coordinated fiscal action between EIB and ECB?

Significant eurozone budget of 5-7 % GDP (MacDougall)

8
→ German and Hanseatic resistance?

Thank you very much!

anttironkainen @ twitter