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From Antigrowth Bias to Quantitative Easing: The ECB's Belated Conversion?

by

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ABSTRACT

This paper investigates the European Central Bank's (ECB) monetary policies. It identifies an antigrowth bias in the bank's monetary policy approach: the ECB is quick to hike, but slow to ease. Similarly, while other players and institutional deficiencies share responsibility for the euro's failure, the bank has generally done "too little, too late" with regard to managing the euro crisis, preventing protracted stagnation, and containing deflation threats. The bank remains attached to the euro area's official competitive wage-repression strategy, which is in conflict with the ECB's price stability mandate and undermines its more recent, unconventional monetary policy initiatives designed to restore price stability. The ECB needs a "Euro Treasury" partner to overcome the euro regime's most serious flaw: the divorce between central bank and treasury institutions.

Keywords: Central Banking; Monetary Policy; Euro Crisis; Lender of Last Resort; Euro Treasury

JEL Classifications: E30, E42, E52, E58, E61, E65

1. INTRODUCTION

This paper investigates the European Central Bank's (ECB) monetary policies from the euro's inception until today, focusing on the currency union's aggregate growth and inflation performance, as well as intra-area divergences and imbalances and the still-unresolved crisis these gave rise to. We identify an antigrowth bias in the ECB's monetary policy approach. Regarding the ECB's crisis management, we find that the ECB has generally done "too little, too late" to prevent the euro area from slipping into recession and protracted stagnation. Despite its recent policy initiatives, the ECB continues to be guided by ideas that will harm rather than nurture the performance of Europe's currency union.

Section 2 pinpoints some important peculiarities of the euro currency union and its central bank as a guardian of stability. Section 3 reviews the euro area's aggregate performance, while section 4 focuses on important intra-area divergences and imbalances. Section 5 assesses the ECB's policy conduct from 1999 until 2014. Section 6 then discusses the bank's more recent policy initiatives to counter deflation threats featuring "quantitative easing" (QE). Having diagnosed that the ECB's prescription of QE policy paired with area-wide competitive wage repression is bound to fail, section 7 sketches an alternative plan for a rudimentary fiscal union that is not a transfer union. Section 8 concludes.

2. THE ECB: A PECULIAR CENTRAL BANK IN CHARGE OF A UNIQUE CURRENCY UNION

The institutional setup and policy regime agreed upon for Europe's Economic and Monetary Union (EMU) at Maastricht in the early 1990s (see Kenen 1995; Dyson and Featherstone 1999; James 2012) is exceptional in featuring a federal supranational monetary authority paired with national fiscal authorities. Reflecting the fact that the EU—or, more specifically, the subset of EU member states that have actually adopted the euro as their common currency, officially "the euro area"—is not a political union, there is no supranational fiscal authority and no common federal budget (to speak of). The ECB is a central bank without a treasury partner, and the euro a

currency without a state (Padoa-Schioppa 2004). At Maastricht, member states agreed to surrender—and pool—their monetary, but not their fiscal sovereignty.

The divorce between money and the state, between monetary and fiscal policies, has always seemed alien and troublesome from a Chartalist perspective (Godley 1992; Goodhart 1992; 1998), concerns that were proved exactly right by experience.¹ As a result of the original sin of creating the euro as a currency without a state, the euro’s supposed guardian, the ECB, turned out to be a vulnerable central bank in charge of a rather fragile currency union. Today, even the EU / euro-area authorities speak of an “incomplete” currency union that needs to be complemented by some kind of central fiscal authority (a “euro treasury”; see van Rompoy [2012] and Juncker et al. [2015]), thereby avoiding the more accurate description of the current currency union as a flawed one.

Looking back, the German designers of the “Maastricht regime” thought that by establishing the ECB as the world’s most independent central bank charged with the primary mandate of maintaining price stability, this would literally guarantee a super-strong position for the ECB—and hence the ultimate soundness of the euro. The Maastricht regime designers spent considerable effort in conceiving of safeguards that would ensure the sought-after peculiar divorce and envisaged watertight separation between fiscal and monetary policies. Additional constraints were also placed on national fiscal policies in the form of deficit and debt limits, so that a lack of fiscal discipline could not present any threat to price stability or the soundness of the euro either.

For their part the ECB, as well as the national central banks (NCBs) of euro-area member states—together forming the “Eurosystem”—are prohibited from “monetizing” public debt through purchases in primary markets or providing any kind of overdraft loans to fiscal authorities. Finally, the national partners are also protected from each other’s failings by the so-

¹ Chartalism holds that money is a creature of the state, which contrasts with mainstream conceptions of money as a commodity that, due to the ingenuity of market forces, helps overcome the inefficiencies of barter. The term “Chartalism” is generally attributed to the German economist Georg Friedrich Knapp. Chartalism was endorsed by Keynes and has a modern following among Post Keynesians. See Wray (2012) on Modern Money Theory.

called “no bailout” clause, supposedly containing any national fiscal solvency issues at the respective national level at which they might arise.

Historically, central banks have evolved fulfilling various functions in three broad policy areas related to the currency sphere and the financial system, namely, public finances, financial stability, and monetary policy (Goodhart 1988). By contrast, the ECB was narrowly conceived of as a monetary authority that is completely decoupled from public finances (except for its monetary income) and only plays a limited role in financial stability policy. Conceptually, the ECB is based on a “narrow central bank” model. In particular, among the “basic tasks” laid down in Treaty on the Functioning of the European Union (TFEU) Article 127, it features the duty to “promote the smooth operation of the payments systems.” Beyond that, however, Article 127 merely asks that “the European System of Central Banks (ESCB) shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system.” Banking supervision and “lending of last resort” to troubled banks therefore also remained national affairs.

In a way, this was a logical consequence of the absence of fiscal union: the lack of federal fiscal resources to backstop financial stability policy at the federal level. For, if lending of last resort and bank bailouts were to result in any losses, these would need to be borne by the national fiscal authorities (and respective taxpayers). In turn, if the national authorities have to pick up the bill, they will almost certainly want to make sure to also have authority over banking supervision and resolution (Goodhart and Schoenmaker 1995, 2006).

The euro crisis experienced since 2008 has made it clear that the truly abnormal monetary-fiscal divorce at the heart of Europe’s currency union regime does not yield strength but weakness. At the center of the regime stands a peculiarly streamlined federal central bank that is focused on little else but monetary policy. Granted a hegemonic macro policy position, together with a mandate that prioritizes price stability, the ECB is presiding over a central banking system that includes national central banks with broader responsibilities in the financial stability domain.

In particular, national central banks have maintained their natural position as lenders of last resort to financial institutions within their respective national policy domains, a responsibility that is traditionally backstopped by the respective national finance ministry. The national finance ministries, in turn, however were effectively cut off from their own natural emergency liquidity backstop—their national central bank—with no federal lender of last resort being put in place in its stead and no federal fiscal capacity established either. Lacking a central bank partner, the national treasuries are subject to default and, hence, runs. National treasuries may have notionally retained fiscal policy authority, but lacking a central bank partner they have lost effective control over national fiscal affairs, just as NCBs’ have lost control over national monetary affairs. Yet the national authorities are supposed to assure the viability of their respective national banking systems as these evolve and become more integrated and pan-European (Goodhart 1998).

As the ultimate source of euro liquidity the ECB may at first seem all powerful. However, lacking a Euro Treasury partner and Euro Treasury debt, the ECB has become subjected to legal challenges of its quasi-fiscal policies as applied to national debts (Bibow 2015). The monetary-fiscal divorce is also the ultimate root of the infamous “bank-sovereign doom loop” (Merler and Pisani-Ferry 2012), which arises as the two parties are closely intertwined in terms of their liquidity and solvency status. Banks typically hold debts issued by their sovereign as liquid and safe investments and government debt securities also play a critical role as collateral and as the financial system’s safe asset more generally. A sovereign downgrade can therefore have a profound impact on banks in particular. The sovereign, in turn, not only relies on banks as lenders/investors, but is also the ultimate fiscal backstop when banks need to be recapitalized to avoid a financial meltdown. Banking problems thus can have severe budgetary consequences.

We will return to the issue of the overriding source of systemic vulnerability in Europe’s currency union, recent regime reforms undertaken (or under discussion) in view of it, and the ECB’s role as the euro’s savior further below in section 6. The remainder of this section serves to highlight that, quite apart from these deeper institutional deficiencies that plague the euro and its guardian, the ECB also started out on the adventure of “stability-oriented” monetary policies in the euro area with a flawed mindset. The flaw consists of a peculiar asymmetry in its approach to

monetary policy that amounts to an antigrowth bias. Since the euro's inception in 1999, the ECB has revealed a special gift for detecting inflationary risks, even when no one else can, paired with remarkable complacency with regard to deflationary risks. As a result, the ECB is always quick to hike, but conspicuously slow to ease, its monetary stance—an asymmetry in mindset and approach that amounts to an antigrowth bias (Bibow 2012).

It is important to point out the historical origin of this peculiar asymmetry. The ECB inherited its antigrowth bias from the German Bundesbank, which served as its model, both institutionally and intellectually. The Bundesbank is famous for both its own monetary “hawkishness” as well as Germany's low inflation record; the latter outcome being typically attributed to the former quality (Marsh 1992). Simply put, as a matter of principle, the Bundesbank abstained from deliberately stimulating domestic demand and employment. Instead its role was that of chief enforcer of discipline, both in budgeting and wages. These observations beg the question why historically “stability-oriented” monetary policy actually proved compatible with economic growth in the case of the Bundesbank. The answer to this apparent puzzle is that West Germany got away with the Bundesbank's asymmetric style of monetary policy *exactly because and as long as West Germany's main trade partners did not share it* (Bibow 2012).

The point is that during the post-WWII era West Germany had inflation that was generally below its main trading partners' inflation trends with whom it shared pegged nominal exchange rates—at first globally under the Bretton Woods regime, later regionally under the Exchange Rate Mechanism (ERM) of the European Monetary System (EMS) (Emminger 1986; Hölscher 1994; Holtfrerich 1999, 2008). In this way, by enforcing budgetary and wage discipline, the Bundesbank boosted West Germany's external competitiveness—and West Germany could notoriously rely on (net) exports rather than domestic demand as its growth engine.

Indirectly price stability therefore *caused* growth in Germany—at least in pre-euro times. It should have been obvious that the German model would run into trouble as soon as it was exported to Germany's main trading partners—which is precisely what the euro currency union was all about (Bibow 2012).

And so Germany promptly ran into trouble in the 1990s, even before the euro was launched at the end of the decade. Germany's struggles in the 1990s—which earned Germany the title of “sick man of the euro” in due course—are widely attributed to the “burden” of German unification. German unification has involved persistent transfers from west to east, an intra-German “transfer union” that is also relevant in the wider euro context today. Essentially, the German transfer union was a consequence of fast-track wage convergence between east and west despite large disparities in productivity levels, leaving former East Germany uncompetitive.

Yet to attribute Germany's sickness under the euro to unification is missing the point. Germany's protracted weakness in domestic demand growth since German unification is owed to other factors. First among them was the Bundesbank's ultra-tight money attack in 1991, which was joined by a (quasi-permanent) U-turn in fiscal stance to unconditional austerity in 1992. The European context is important here, too. Tight money by the Bundesbank tore the ERM apart and, for once, restored competitiveness positions within the region: West Germany's huge (pre-unification) external surplus of 1989 turned into a small deficit position in the 1990s (reflecting lasting competitiveness issues of former East Germany). Also, Germany did not embark on fiscal austerity alone in the early 1990s (Fitoussi et al. 1993). In the name of Maastricht much of Europe joined in, while inflation and interest rates generally converged (i.e., declined) toward German levels in the run-up to the euro's launch in 1999.

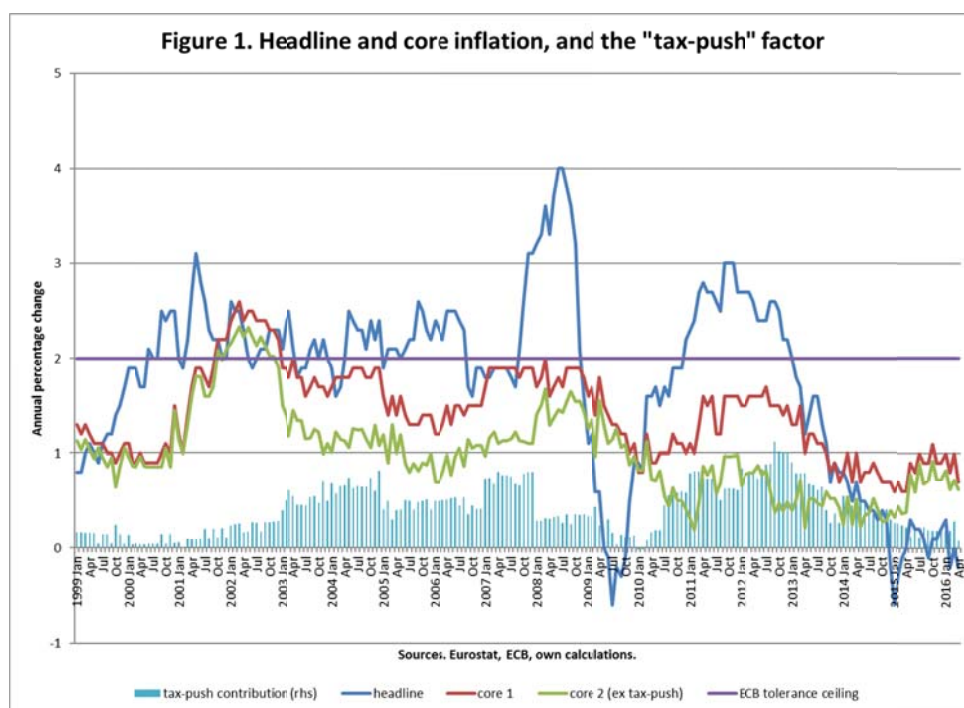
The region-wide endeavor at “stability-oriented” macro policies (quite predictably!) caused poor macroeconomic performance, which, in turn, worsened the budgetary and employment challenges. With continent-wide fiscal austerity and disinflation the euro had trouble getting off the ground. The euro's launch was delayed until 1999 as hardly any country could fulfill the fiscal “convergence criteria” of entry into Europe's “stability union” any earlier, including Germany. It was only when the US “dot.com” boom and dollar appreciation lent sufficient external support to growth that the euro got its (last-minute) chance for takeoff at the end of the millennium after all.

The “convergence” experience of the 1990s provided a foretaste of things to come. Germany's policy response to the fact that its old model stopped working in its country of origin when

pursued jointly across the region was going to add a special flavor to the euro experiment's later failure. The next section provides a brief assessment of the euro area's macroeconomic performance until 2008.

3. THE EURO AREA'S AGGREGATE PERFORMANCE: INFLATION, GROWTH, AND THE LABOR MARKET

The ECB's monetary policy is focused on the Harmonized Index of Consumer Prices (HICP) for the euro area as a whole. The ECB initially declared that it would aim at keeping HICP inflation "below 2 percent" (in the medium term), but the bank later "clarified" that its goal was to keep HICP inflation "below but close to 2 percent."² Figure 1 shows the actual evolution of HICP inflation since the euro's launch. (Apart from the HICP "headline" inflation measure to which the discussion here refers, there are also two "core" inflation measures shown that will be discussed further below.)



² The ECB's monetary policy strategy and lack of transparency prompted considerable confusion and criticism. See, for instance, the annual monitoring exercises of the Alesina et al. (2001), Begg et al. (2002), and Gali et al. (2004), for instance, as well as Buiter (1999), and Wyplosz (2001).

In early 1999, inflation was well-below 2 percent and unemployment was high. In an environment of sluggish growth, inflation had declined across the euro area in the run-up to EMU even before the global impact of the Asian crises³ of 1997–98 provided an additional disinflationary force. Following the euro’s launch, inflation accelerated quite sharply in 1999 and 2000 to briefly peak at almost 3 percent in early 2001. This occurred during the final stage of the US dot.com boom that also saw a brief rise in euro-area domestic demand. Oil prices soared and the euro plunged at the time.

Reversing its initial plunge, the euro had started appreciating in 2002 and was quite strong by 2006–07. Oil and commodity prices more generally surged to record levels until the summer of 2008. Much to the ECB’s embarrassment inflation then stayed *above* 2 percent for most of the time until 2009. There was a brief but sharp rise in inflation in 2008, just prior to the global financial crisis, peaking at close to 4 percent—before plunging into negative territory in 2009.

Following its sharp decline, inflation quickly rebounded with the global recovery in 2010 and briefly hit 3 percent in 2011. Inflation declined again thereafter as the euro area was succumbing to protracted stagnation, at first slowly, but then quite rapidly in 2013, falling below zero by the end of 2014. Inflation has been hovering around zero ever since.

³ Following financial liberalization, large capital inflows, and competitiveness losses, currency attacks and financial crises (starting with Thailand in mid-1997) spread throughout East Asia leaving economic devastation in its wake. Tumbling commodity prices and the resulting deflationary shock saw rising fears of global contagion, as happened in the case of Russia and the failure of Long-Term Capital Management, a hedge fund in the United States, in 1998.

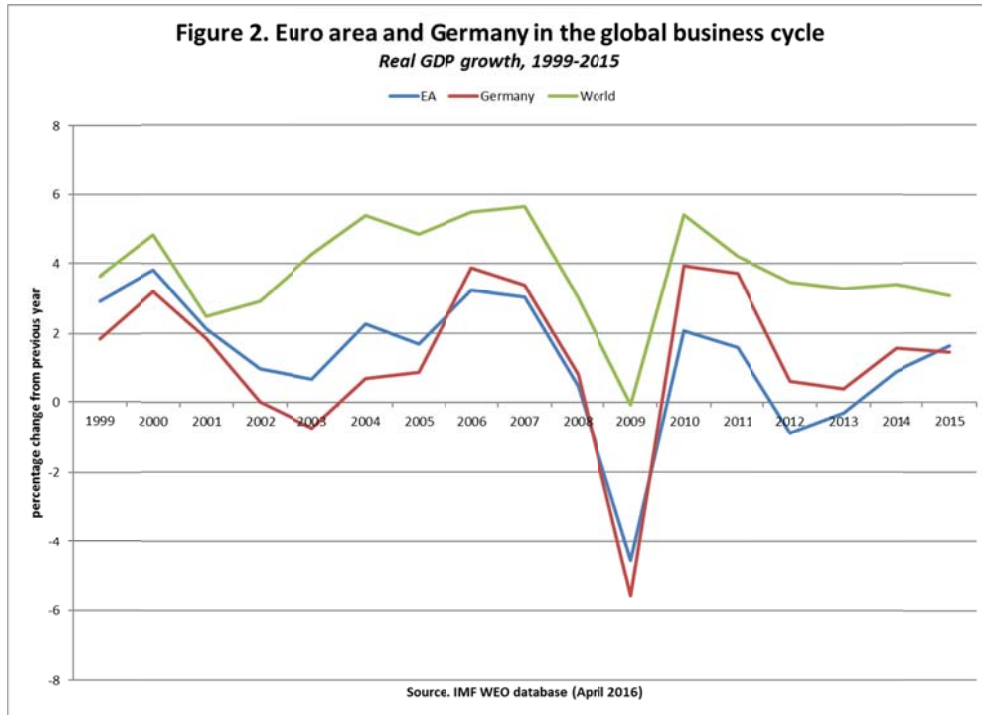


Figure 2 shows the euro area and Germany’s respective GDP growth rates since 1999, as well as global growth. After enjoying a brief spurt in growth in 2000, the euro area participated in the “global slowdown” of 2001. In fact, growth remained stuck in low gear for a number of years and the euro area only joined the record global boom of the 2000s when it was on its last leg. Germany’s performance during this period was outstandingly poor.

The euro area and Germany then experienced an especially steep plummet in the context of the global crisis of 2008–09. While the immediate rebound was quite strong, it proved to be short lived and was followed by another recession and protracted stagnation, with Germany becoming the euro area’s supposed growth engine since 2010. Overall, the “recovery” in Germany and throughout the currency union has remained extraordinarily slow and fragile until today.

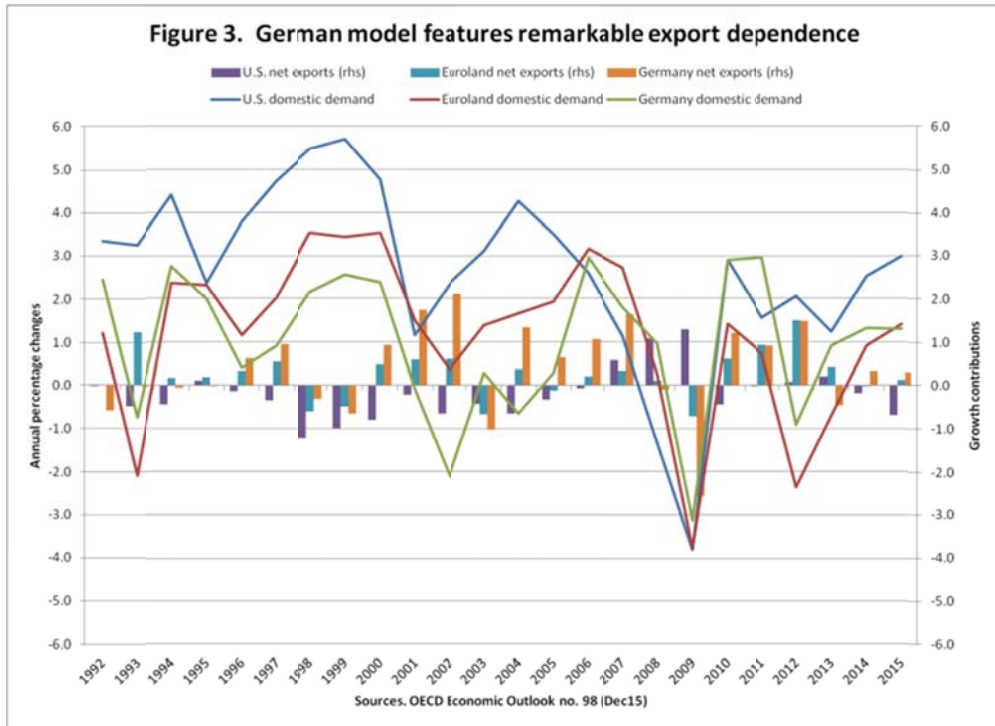
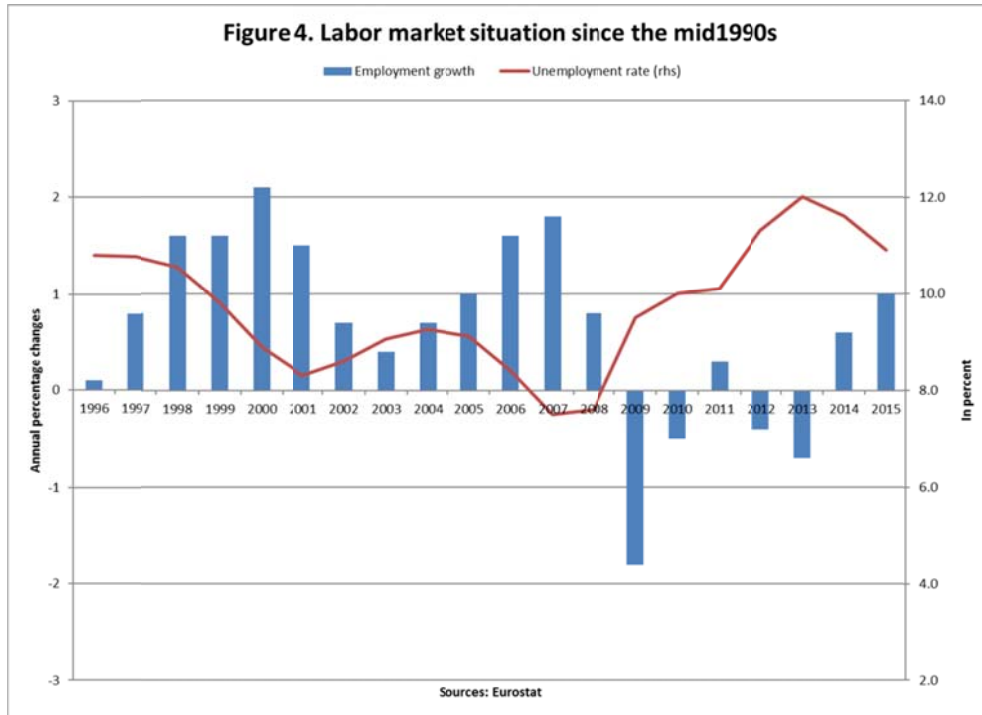


Figure 3 decomposes GDP growth in Germany, the euro area, and the US into contributions from domestic demand and net exports. The data shown here goes back to 1992 to highlight the “Maastricht pattern” that characterizes the “German model”: the inability to generate steady domestic demand-driven growth paired with a conspicuous reliance on (net) exports to make up for it. Figure 3 shows the critical external stimulus in 1996–97 that allowed the euro to get off the ground. The stimulating impact of the global boom of the 2000s was contained by the euro’s appreciation since 2002. In the aftermath of the global crisis the situation has become especially stark: acting as its external lifeline, the rest of the world prevented the euro currency union from drowning itself.



Needless to say, the labor-market situation neatly mirrors these trends. Official rhetoric might suggest that all of the euro area’s problems are “structural” in nature, justifying the never-ending calls for “structural reform” as a precondition for stronger growth. In reality, employment growth and unemployment levels are strongly cyclical and primarily driven by the euro area’s peculiar cycle of brief booms and long periods of protracted stagnation. In early 2016, the euro area is still plagued by mass unemployment because it went through a double-dip recession and has barely recovered to its pre-crisis level of GDP. It is no big surprise then that public finances have not only been severely impacted by banking problems but also suffered the consequences of poor growth and high unemployment.

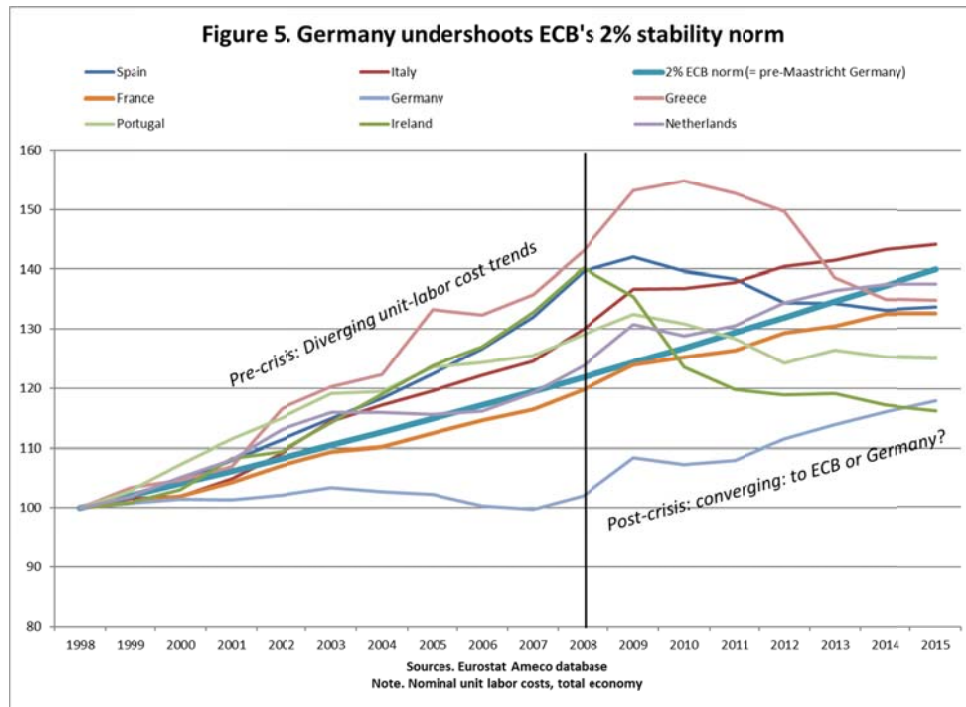
In conclusion, regarding the euro area’s aggregate performance, the fact that stands out is that the currency union fully participates in any global slowdown, recession, or crisis, but generally struggles to recover from downturns by nourishing sufficiently strong domestic demand growth. Put differently, given its size, the euro area is conspicuously reliant on global growth. These patterns perfectly match what was to be expected in light of the German influence on the Maastricht regime, and we will further investigate the ECB’s actual policies to confirm the bank’s hypothesized “antigrowth bias” in section 5, but first the next section will zoom in on the

issue of intra-area divergences, which, it turns out, have also been a product that was “made in Germany.”

4. INTRA-AREA DIVERGENCES AND BUILDUP OF IMBALANCES

German wage repression, nationally orchestrated to gain competitiveness, provided the root cause behind persistent intra-area divergences and related imbalances under the euro; the legacy challenges that resulted from their implosion are at the heart of the still-unresolved euro crisis. The same pattern had previously played out under the EMS. German unification and the ERM crises then temporarily rebalanced Europe. Alas, the deep recession of 1992–93 lastingly derailed the German economy. In an environment of continent-wide austerity and convergence to Germany’s low inflation norm in the name of Maastricht, the German model of export-led growth failed to ignite for Germany in the 1990s.

Given an atypically balanced external position and the failure of exports to kick-start growth, Germany’s knee-jerk reaction was to embark on “restoring” its competitiveness by way of wage repression. Note the irony here: at the very time when Europe hooked up to Germany’s “stability culture,” which inevitably meant that said model would no longer work for Germany (within Europe) because the model was dependent on others behaving differently, *Germany set out to renege on the Maastricht deal by systematically underbidding its euro partners*. The euro was the coronation of Europe’s postwar endeavor to prevent any repeat of collective ruin through beggar-thy-neighbor policies as experienced in the 1930s, but with the currency weapon finally gone for good thanks to the euro, Germany applied the wage weapon instead. The consequences have proven truly calamitous.



Germany’s fateful move actually started a few years before the euro’s launch and it lasted until very recently. All along German wage increases barely made up for (low!) German inflation (itself depressed by wage repression and high unemployment). Political pressure, the systematic weakening of unions, and, at its final stage, the infamous “Hartz reforms” all played their part. As a result, for a period of over a decade, German unit labor costs (total economy) essentially stayed flat (Flassbeck 2007). Starkly contradicting the “golden rule of monetary union,” which requires that the members of a currency union abide by their agreed-upon common inflation rate (or risk unleashing an asymmetric shock), figure 5 shows that Germany lastingly departed from the ECB’s stability norm of 2 percent in the downward direction. It is fallacious to argue that Germany had to “restore” its competitiveness when it started out from a balanced external position but ended up with the biggest external imbalance in the world.

While German wage repression thereby unleashed a perfectly avoidable asymmetric shock, the Maastricht regime of the EMU itself amplified intra-union divergences once they got underway. In Germany, wage repression undermined both private consumption (directly) and private investment (indirectly), also owing to relatively tight financial conditions due to below-average inflation and domestic credit issues. As stagnant private spending and high unemployment

caused budgetary troubles, the procyclical workings of the so-called Stability and Growth Pact (SGP) added further pain. Germany's struggles with the SGP were not for lack of trying. Missing the holy 3 percent (of GDP) budget-deficit limit for five years in a row, Germany stubbornly responded with ever-new austerity measures.

The opposite kinds of developments were observable in the “euro periphery.” The interest rate convergence process was essentially complete by the time of the euro's launch. As German domestic demand stagnation then dragged down monetary conditions area-wide, financial conditions in countries with more normal wage-price inflation trends became ultra-easy. In this way an endogenous asymmetric shock arose and was amplified by the ECB's “one-size-fits-none” monetary policy stance: too tight for stagnant Germany, but way too easy for the booming periphery—where asset price bubbles took off as a result. If anything, gushing government revenues and the SGP enabled fiscal stimulus, whilst austerity was applied in Germany. All along, liberalized European banks unleashed a lending bonanza and surging capital flows. In the process the euro periphery ran up net external debts of around 100 percent of GDP. It was only a matter of time for lending/borrowing binges to stall and reverse, and for bubbles to burst. The Lehman bust provided the trigger. Europe's banks were hit by a double whammy, struggling with losses on both US and European exposures that caused devastating balance-sheet damage.

The ECB's contribution and responsibility with regard to intra-area divergences is not obvious at first. A key tenet of “optimum currency area” (OCA) theory is that monetary policy can, at best, be calibrated to suit the “average” of the currency union, as there is only one common interest rate, the size (level) of which has to fit all. If circumstances and policy requirements vary across the currency union, monetary policy itself will become a driver of intra-area divergences (as highlighted above). It is thus critical how the ECB diagnosed and responded to any emerging divergences and imbalances. In particular, how did the ECB prepare for any eventual challenges that could arise from these developments?

Regarding divergences and imbalances the facts that stand out are that the ECB misjudged the role of unit-labor cost and competitiveness trends and also treated the resulting current account and financial imbalances in a remarkably nonchalant way. If anything, Jean-Claude Trichet, ECB

president from 2003–11, even acted as cheerleader of wage repression in Germany.⁴

Furthermore, the ECB blindly assumed that banks were implementing effective risk management policies, venturing that the “competitiveness (‘real exchange rate’) channel, although slow to build up, eventually becomes the dominating adjustment factor” (ECB 2005: 77), supposedly taking care of any imbalances in nondisruptive ways.⁵

Fast forward ten years. In a way, the ECB’s never-ending push for “structural reform” of labor markets still follows the same—flawed—pre-crisis reasoning. Today “structural reform” is seen as facilitating “internal devaluation” vis-à-vis Germany, with the inevitable result that the ECB is massively undershooting its price stability mandate. Only very belatedly has the ECB embarked on “quantitative easing” to counter the resulting deflation threats at all, as section 6 will discuss. First, the next section will investigate the ECB’s monetary policy from 1999 until 2014.

5. ECB MONETARY POLICY: 1999–2014

The core principles of the ECB’s monetary policy implementation are straightforward: the ECB sets the price of short-term central bank liquidity by announcing its policy rates, and then meets the demand for liquidity arising at the stated price against collateral of a certain specified minimum quality in dealing with certain accepted counterparties (Bindseil 2004). The communication of its policy rates is framed in terms of a policy strategy that features a variety of short-term economic indicators while also reserving a special role for the monetary aggregate M3. From early on the ECB found an elegant solution to fulfilling its official treaty obligation by

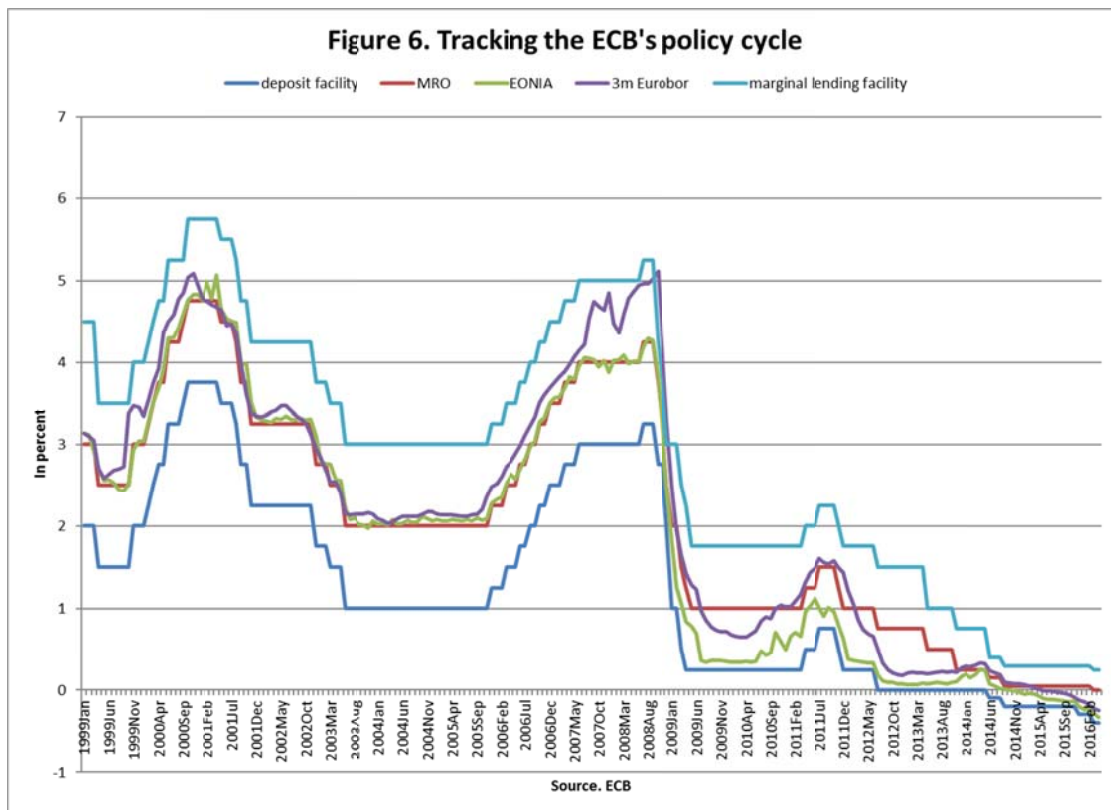
⁴ For instance, Trichet (2006) observed on the successes and challenges of EMU and the euro that:

Within a monetary union with increased price and cost comparability it is of paramount importance that firms remain competitive by controlling domestic cost developments as captured by, for example, unit labor costs. This is exemplarily illustrated in the case of Germany which had lost competitiveness due to reunification, and which embarked on a catching up exercise between 1999 and 2005, witnessing only limited cumulated unit labor cost increases of 2.6 percent compared to a euro area average of 11.2 percent. This significant improvement of the German economy’s competitiveness is one of the explanations for its strong export performance.

⁵ The ECB’s chief economist at the time, Otmar Issing, seemed impressed by how well the ECB’s one-size interest rate policy was fitting the euro currency union (see Issing 2005). In fact, even on the eve of the global financial crisis the euro authorities seemed completely unaware of what was coming (see Almunia 2008).

contributing to objectives other than price stability. The ECB simply asserts that “maintaining price stability *in itself* contributes to the achievement of output and employment goals” (ECB 1999: 40; emphasis added⁶)—the old Bundesbank mantra that price stability *causes* growth.

Owing to peculiar circumstances (as highlighted above), this model actually worked for West Germany and the Bundesbank in pre-euro times; however, the German model has backfired quite badly for the ECB and Europe’s currency union. The ECB’s asymmetric policy approach has actualized as an antigrowth bias that has proven not only detrimental in terms of growth but also counterproductive with regard to the ECB’s primary price stability goal.



⁶ The ECB’s interpretation of its mandate has caused some irritation, as the following example illustrates:

In this remarkable interpretation of the Treaty, the ECB fulfills its double mandate by reducing it to a single responsibility, a focus solely on price stability. All other objectives are then realized automatically. In this view the ECB cannot be held responsible for what happens in the real economy. We consider that this view is not just narrow, but mistaken. (Begg et al. 2002: 12)

Figure 6 shows the evolution of the ECB's policy stance since 1999, featuring two full interest-rate cycles (with some aberrations). The ECB's policy interest rate of 3 percent at the start seemed low when viewed against the background of the high-interest rate era of the 1980s and 90s, but with inflation below 1 percent and uncertainty elevated owing to the Asian crises, the ECB's first move was actually an interest rate cut to 2.5 percent in the spring of 1999. What then followed was the first demonstration of the ECB's inclination to aggressively hike interest rates, even if preemptively, for reasons of perceived inflation threats. In view of developments on the domestic demand front, the ECB's hikes were clearly overdone. Curiously, they even proved counterproductive with regard to price stability, namely by crashing the euro and pushing up import prices.

The peculiar financial market climate prevailing at the time was very pro-growth, just as the Greenspan Fed was judged as very growth-friendly at the time. And so the ECB's aggressive inflation-fighting mindset ran into a time-inconsistency problem: by undermining the euro area's growth prospects the ECB's aggressive hikes were judged unsustainable. In this way, the ECB's hikes plunged the euro, which, in the fall of 2000, even led to coordinated currency market interventions (Bibow 2012).⁷

Apart from choking domestic demand growth, by crashing the euro the ECB's hikes also pushed up inflation. Headline inflation rose *above* 2 percent by mid-2000. On the other hand, the rise in core inflation was delayed until 2001 (see figure 1, above) and only happened as productivity growth stalled in the recession, with economic weakness rather than strength pushing up unit labor costs. Persisting with its inflation obsession, the ECB misdiagnosed its failure to maintain price stability and saw this as an excuse to ease its policy stance only very slowly. In intricate ways its reluctance to ease and failure to provide sufficient support to the flagging economy only led to fresh problems and more upward pressure on inflation.

⁷ The European Commission (2000: 71) correctly foresaw actual outcomes: "To the extent that the depreciation in the euro is due to cyclical divergence between the euro area and the United States, a rise in interest rates in an attempt to support the currency could even backfire if it was perceived as stifling the euro-area recovery. The risk of creating an even more unbalanced growth pattern with weak domestic demand and higher export growth would be serious."

The ECB's policy inaction saw the euro appreciate strongly starting in 2002 as the US Federal Reserve acted aggressively against perceived deflation threats. Euro appreciation contained the external stimulus the euro area received in the 2000s. Stagnant growth caused persistent budgetary pressures; numerous countries, including Germany, ran into conflict with the SGP. In response they implemented various hikes in indirect taxes and administered prices—*pushing inflation up*.

Figure 1 above reveals a sizeable upward distortion in headline inflation caused by budgetary measures. “Tax-push inflation” was largely responsible for keeping inflation above 2 percent for most of the time until the second half of 2006. The mix of too-tight money and fiscal tightening proved counterproductive for both growth and price stability. In 2006 inflation finally fell back below 2 percent, while domestic demand growth was awakening. After having been outstandingly slow to ease, the ECB was ready to embark on its second tightening binge.

Not for very long though, as once again the ECB would continue tightening well beyond the turning point in domestic demand growth. There was a temporary surge in headline inflation largely driven by oil and other commodity prices that scared the ECB. Adjusted for the tax-push distortion, core inflation barely reached 1.5 percent in 2008. Headline inflation then declined sharply in the second half of 2008 and turned negative in 2009. This time around the ECB cut its policy rates quite quickly, at least by its own standards. Compared to its international peers the ECB eased its stance more timidly and with more delay, and until 2015 it largely abstained from large-scale asset purchases of public debt (also known as QE), which, at this time, also had the side-effect of bolstering the euro.

Regarding the ECB's crisis management until 2014 we may attest to the fact that the ECB proved reasonably creative in meeting the euro-area banking systems' liquidity needs. In particular, the ECB switched to the full allotment of any liquidity bids at a fixed rate (“fixed-rate full-allotment,” or FRFA) from early on as stress emerged. Over time the ECB extended the maturities of loans offered to banks while easing its collateral requirements considerably. In addition, first in May 2009, the ECB established special market programs (for instance in support of covered bonds), which serve as an important funding market for banks. Overall, the ECB

managed to keep the euro-area banking systems afloat even at times of acute and widespread solvency concerns (Bindseil 2014; Bibow 2012, 2015; Claeys 2014).

The ECB was far less forthcoming in supporting public debt though (De Grauwe 2013; Winkler 2014), and the limited support it did provide at critical junctures proved highly controversial. The first such occasion was the “Securities Markets Programme” (SMP) established in May 2010. The declared objective of the SMP was to “address the malfunctioning of certain euro-area debt securities market segments and to ensure an appropriate monetary policy transmission mechanism” (ECB 2011: 100). Initially, ECB purchases focused on Greek government bonds. As the “sovereign debt crisis” spread they also included public debts issued by Ireland, Portugal, Italy, and Spain. To counter suspicions of “monetary financing” the ECB fully “sterilized” these purchases. Nonetheless the bank faced controversies, as well as legal challenges to its policies (with cases brought to both Germany’s Federal Constitutional Court and the European Court of Justice; see Bastasin 2015).

Supplementing its comprehensive liquidity support of banking systems with rather half-hearted support of governments failed to stall the (bank-sovereign) “doom loop” and prevent it from spreading across the currency union. Government bond spreads vis-à-vis Germany’s surged—heralding severe financial fragmentation. Bank rescues and guarantees had stretched public finances. Soaring sovereign bond spreads, in turn, weakened already fragile banks even further. As a result, a severe credit crunch hit the euro-area economy, concentrated in euro-crisis countries. This came on top of counterproductively harsh fiscal austerity measures demanded by Germany. As the economy fell into protracted recession and unemployment soared, this only further weakened both public finances and the banks.

Once again confirming its antigrowth bias, the ECB prematurely hiked interest rates twice in April and July of 2011, marking the end of Jean-Claude Trichet’s presidency. The trigger-happy ECB then had to quickly backpedal under its new president, Mario Draghi, as acute market stress—and mounting fears of a “euro breakup”—escalated until August 2012. Not only did the ECB cut its interest rates to new lows (twice in late 2011 and again in July 2012), it also launched its second Covered Bond Purchase Programme, reactivated the SMP, and halved its

reserve requirement ratio in January 2012. In late 2011 it had also launched the first of two very-long-term (3 years) liquidity operations to meet the banks' surging liquidity demands.

The spectacular rise in "TARGET 2 imbalances" at the time reflected the fact that the euro area was hit by a "sudden stop / sudden reversal" in capital flows, or a quasi-balance of payments crisis inside the euro currency union featuring runs on the banking systems of euro-crisis countries. The euro monetary union is not based on a unified (or one-tier) central bank balance sheet providing the ultimate settlement asset for a unified area-wide payment system. Related to the absence of fiscal union the Eurosystem is a two-tier central bank system that includes the national central banks. The **T**rans-**E**uropean **A**utomated **R**eal-time **G**ross settlement **E**xpress **T**ransfer (TARGET) system is the facility that interlinks the national payment systems.

TARGET2 is the payment infrastructure backbone of the euro. It is the precondition for money market integration across the area which, in turn, is a precondition for implementing the ECB's single monetary policy. In normal times banks recycle any payments imbalances through money ("inter-bank") markets. When the banking systems of euro-crisis countries were hit by (wholesale) "runs," the ECB faced the choice to either provide emergency liquidity or, in effect, shut down TARGET2 and watch the fragmentation of the euro monetary union. The ECB chose not to allow the latter course. Effectively, its liberal liquidity provision enabled the money market to shift onto the Eurosystem's balance sheet. TARGET2 balances of crisis countries will show deficits, while the corresponding surpluses show up in "haven" countries (see Bindseil and Koenig 2011; Cecchetti, McCauley, and McGuire 2012).

In a way, ample liquidity provision by the ECB also preempted the need for even greater recourse to "emergency liquidity assistance" (ELA) offered by the NCBs in euro-crisis countries to their respective banks. While any risks associated with ELA stay national, the extension of liquidity provision through the ECB involves risk-sharing. Effectively, the ECB facilitated the flight of creditor-country banks, which would have suffered huge losses if banks in euro-crisis countries had been allowed to go down *en masse*.

Despite the ECB's ample liquidity provision, market stress and financial fragmentation continued to escalate until August 2012—when Mario Draghi finally managed to break the panic

and swing the market mood around with his famous “whatever it takes” speech, delivered in London in late July. The promise was quickly followed up by the ECB’s official announcement of “outright open market operations” (OMT) on August 2, 2012. The announcement of the ECB’s OMT program proved effective but even more controversial than the earlier SMP that it replaced (Bastasin 2015). If activated, OMTs would focus on sovereign bonds with a maturity of between one and three years. While no *ex ante* quantitative limit was set, any liquidity created through purchases would be fully sterilized. The ECB’s justification of the program emphasized the price stability mandate and the need to restore the “singleness” of monetary policy. Mario Draghi also reiterated announcements by the euro area’s political authorities that the euro was “irreversible.”

Financial markets returned to calmer waters only very gradually and high levels of financial fragmentation persisted. The euro area officially emerged from its double-dip recession in the spring of 2013. It was only in the summer of that year that domestic demand finally stabilized after two years of decline. As fiscal austerity was eased, a very fragile recovery began. All along inflation continued its gradual decline. For a time, the ECB appeared relaxed about both the decline in inflation and the continuing shrinking of its balance sheet as banks used the option of early repayment of the ECB’s special three-year loans. It was only in the summer of 2014, as inflation expectations also shifted sharply downwards, that the ECB finally concluded that more aggressive measures may be needed to halt unwanted disinflation. Among other measures, this led to the launching of a QE program in 2015, which will be the subject of the next section.

As to the ECB’s monetary policies from 1999 until 2014, we have confirmed the suspected asymmetry in mindset and approach that the ECB inherited from the Bundesbank: the ECB is always quick to hike (even as a precaution) but conspicuously slow to ease, even in the face of actual economic weakness.⁸ While a dysfunctional fiscal regime and other factors were also instrumental, the ECB’s antigrowth bias has not only hindered domestic demand growth, but even backfired with respect to the primary price stability goal as well. In the absence of

⁸ In 2004, Jean-Claude Trichet (2004) explicitly acknowledged that it was normal for the ECB and the euro area under its stewardship to sit out any stagnation in domestic demand and wait for exports to ignite growth—the old Bundesbank model: “Growth starts with exports, then passes on to investment and then to consumption. That is the normal sequence for Europe in this phase of the cycle.”

sufficient support of domestic demand, “tax-push inflation” featured prominently in upward distortions of headline HICP inflation and persistent ECB inflation target misses in the upward direction. More recently the ECB’s record shows huge target misses in the downward direction. This only underlines that in its crisis management the ECB’s actions generally proved “too little, too late” to prevent the euro area from slipping into recession and protracted stagnation.

6. QE TO THE RESCUE: THE ECB’S BELATED CONVERSION?

The euro area had been more or less stuck in recession and stagnation ever since the SMP was first launched in May 2010. Unwarranted disinflation since 2011 left the economy stranded on the brink of outright deflation in 2014, by which time domestic demand was still 5 percent below its pre-crisis peak level. Lending to the real economy had shrunk for years. Apart from a 25 basis point cut in May 2013 and adding “forward guidance” to its communication cum expectation management repertoire (by announcing that it expected policy rates to remain at present or lower levels for an “extended period of time”) in July 2013, the ECB had shown little concern (Ubid 2014; Claeys et al. 2014).

This only changed gradually in the summer of 2014. The ECB cut its policy rates in June and again in September to steer the euro overnight rate into negative territory. This turned the euro into the favored carry trade funding currency and the euro ended 2014 at US\$1.20 when it was still US\$1.40 in March. The ECB launched another covered bonds program (CBPP3) as well as a new program to purchase asset-backed securities (ABSPP), measures designed to foster the healing process of euro-area banks. The ECB terminated the sterilization of the SMPs’ liquidity effect, effectively marking the start of “public debt monetization,” purely for monetary policy purposes. The ECB also embarked on a new series of targeted long-term refinancing operations (TLTRO-I) designed to incentivize lending to the real economy. In his Jackson Hole speech of August 2014, Mario Draghi seemed to announce the arrival of new thinking at the ECB when he identified a clear role for demand-side policies, declaring: “The risks of ‘doing too little’—i.e., that cyclical unemployment becomes structural—outweigh those of ‘doing too much’—that is, excessive upward wage and price pressures” (Draghi 2014). In fact, plunging oil prices on top of

excessive downward wage disinflation were threatening to push the euro area into outright deflation.

And so the ECB finally announced a large-scale asset purchase program (APP) including public debt securities (PSPP) in January 2015.⁹ The declared objective of its QE initiative was to boost the size of the euro area's banking system by about €1 trillion to just over €3 trillion (its previous peak level of 2012) and thereby to push inflation back towards 2 percent. The move represented a policy U-turn, as all of a sudden a majority on the Governing Council came to no longer view QE as hindering structural reform but as facilitating it. In other respects, however, the ECB's thinking has not changed at all. In particular, the ECB still considers structural reform and wage moderation to boost competitiveness as key to the revival of the euro area's fortunes.

Take, for instance, Peter Praet's speech of October 8, 2015, titled "EMU—disappointed expectations and how to move forward." The ECB's chief economist acknowledges there that the performance of Europe's currency union has disappointed expectations, but argues that expectations for positive effects of EMU had been predicated on an

endogenous effect on the quality and efficiency of national economic institutions—by which I mean, among other things, institutions governing competition, wage bargaining, civil justice, banking supervision and fiscal policies. This was because, as governments in a monetary union would have less scope for demand management, they would necessarily focus more on structural reforms. For instance, without the possibility to devalue to regain competitiveness, governments would have to compensate by making changes in product and labour markets to improve the flexibility of relative prices. (Praet 2015: 1–2)

Apart from confusing flexibility of *relative* prices with price *level* flexibility, Praet then goes on to assert that governments had simply done too little in terms of fiscal consolidation and structural reform prior to the crisis, so that they found themselves with insufficient fiscal space and relative price (level) flexibility when crisis struck. More specifically, he squarely blames all failure on those countries that had experienced *losses* in their competitiveness—while there is

⁹ The announcement on January 22, 2015 followed on the heels of a ruling by the European Court of Justice that largely cleared the ECB's earlier highly controversial OMTs of legal challenges as a monetary policy measure. Accordingly, the ECB's communications emphasize that QE represents monetary policy rather than government funding. The program is implemented in a decentralized fashion to avoid risk sharing on 80 percent of the purchases, as the NCBs only purchase their respective national public debt securities.

not a single reference to the fact that one country had registered unwarranted gains in competitiveness thanks to its beggar-thy-neighbor wage repression policy.

Essentially, then, the ECB is still staying its pre-crisis course, as mapped out by Jean-Claude Trichet, who announced in 2005 that Germany's model of wage repression should be followed by everyone. Recall that when Germany alone pursued wage repression it suffocated domestic demand while becoming solely reliant on net exports for its growth—an adventure that provided the ultimate root cause of the later euro crisis. Do not miss the irony here: Europe introduced the euro to forever ban the option of competitive currency devaluation, only to adopt competitive wage repression (“internal devaluation”) as its official policy. It is truly odd to (continue to) expect different results from applying the German experiment jointly today, especially when the euro area's external imbalance is already running at nearly 4 percent of GDP. Figure 1 illustrates the issue very clearly: instead of Germany converging towards the ECB's 2-percent stability trajectory, competitive wage deflation (“internal devaluations”) will see everyone else converge towards the German trajectory—which is way below the ECB's.

There is a clear contradiction between wage policies that can only cause deflation while pursuing QE monetary policies with the declared objective of boosting inflation. Given that the euro area has a flexible exchange rate, the true objective of QE must be that of avoiding the very euro appreciation that the euro area's external position would actually call for. Ultimately this is a very foolish endeavor. It was therefore safe to predict that the EMU would continue to disappoint expectations.

And disappointment came soon enough, so that the ECB decided at the December 2015 council meeting to further ease the interest rate on its deposit facility to -0.30 percent and to extend the duration of its asset purchase program featuring monthly purchases of €60 billion by six months (until the end of March 2017). The next and most recent move shows signs of desperation. In March 2016, the Governing Council decided to further reduce its key policy rates to push money

market rates deeper into hitherto unexplored negative territory.¹⁰ The monthly QE volume was expanded to €80bn starting in April 2016 and purchases will now also include investment-grade bonds issued by nonbank corporations. And the ECB announced that it would launch another targeted long-term financing operation (TLTRO-II) in June, with bank borrowing conditions that can be as low as the rate on the deposit facility (-0.4 percent).

The ECB's measures taken since the summer of 2014 have proved a mixed blessing. Interest rates have fallen across the board and financial fragmentation eased significantly with converging financial conditions. Super-low interest rates are a double-edged sword though since interest income falls accordingly. With nominal interest rates even going negative, German savers started accusing the ECB of "expropriation." Stimulation of domestic demand only arises if borrowing and spending pick up. Alas, the impact on private spending is constrained for as long as households and corporations remain in "deleveraging" mode. The public sector also enjoys a reduced debt-service burden. If the thereby enlarged fiscal space prompts any rise in primary expenditures, monetary easing would have paved the way for a fiscal stimulus. In the context of the euro area's dysfunctional fiscal regime the benefit was more limited to diminished or paused austerity—which by itself has at least provided some support of domestic demand since 2014. The impact on banking needs to be considered, too. Banks' business model thrives or withers on risk and term premiums, which got squeezed by the ECB's measures. Confronted with regulatory tightening, vast legacies of nonperforming loans, and protracted domestic demand stagnation, banks are challenged to offset the squeeze by balance sheet expansion. Negative rates create a special problem. Facing competition from banknotes, banks are thwarted in passing on negative rates (or fees) to retail depositors. Negative rates therefore act like a special tax on retail banking. It is for this reason that the ECB designed its TLTRO-II so as to allow for active banks to borrow from the ECB at negative rates, too (i.e., get paid for borrowing—a subsidy that offsets this tax).

Overall, the ECB's measures by themselves are helpful but unlikely to really fire up domestic demand, while their impact on export demand via the exchange rate is hindered by widespread

¹⁰ The interest rate on the deposit facility was cut by 10 basis points to -0.40 percent and the interest rates on the marginal lending facility and the main refinancing operations by 5 basis points each to 0.25 percent and 0.0 percent, respectively. Money market rates followed suit (see figure 6).

global fragilities.¹¹ In fact, additional euro weakening since 2015 has been rather limited due to competition from other currency warriors and diminished expectations for policy tightening by the US Federal Reserve. Ultimately the problem is that the German model of export-led growth simply cannot work for an economy as large as the euro area. Instead, in order to make the euro viable, the euro area will need to fix its dysfunctional policy regime and reorient policies firmly towards domestic demand-led growth.

7. MAKING THE EURO VIABLE: THE ECB NEEDS A EURO TREASURY PARTNER

The euro regime's essential flaw and ultimate source of vulnerability is the decoupling of central bank and treasury institutions in the euro currency union. The straightforward solution is to establish a "Euro Treasury," namely, a vehicle that pools future euro-area public investment spending funded through the issuance of proper Euro Treasury securities. In order to preclude redistribution, by design the Euro Treasury would allocate investment grants to member states and collect tax to service the interest on the common debt, both exactly in line with member states' GDP shares. Essentially, the Euro Treasury plan would create a very rudimentary fiscal union that is not a transfer union (Bibow 2013). Moreover, the proposed strictly limited federal fiscal system does not presuppose political union either, as the Euro Treasury would function on the basis of a strict rule, the so-called "golden rule of public finance," which foresees that public investment should be debt financed (Musgrave 1939, 1959).

Note that Euro Treasury debt issuance would fund *future* public investment spending but not mutualize any *existing* national debt. Member states alone remain responsible for their national public debts, and they would still be required to abide by all the rules of the current fiscal regime—except that this would apply to *current* public expenditures only, as public capital expenditures would form a separate capital budget funded by the Euro Treasury. Steady deficit spending from the federal center would *enable* the decline of national public debt ratios to low and safe levels.

¹¹ Once again the issue is that the ECB has failed to ease in a timely fashion. Research regarding QE programs of other central banks generally conclude that QE is effective when applied early and aggressively. See Bowler and Radia (2012), Peersman (2014), Rogers, Scotti, and Wright (2014), and Weale and Wieladek (2014), for instance.

The Euro Treasury is not a threat to the ECB but a much-needed partner. The ECB needs federal treasury debt for monetary policy purposes. The ECB could then in the future abstain from operating in national public debt, thereby avoiding legal challenges to such measures. Euro Treasury debt would provide the common safe asset that the markets need to establish a common yield curve of risk-free interest rates. Risky assets could then be priced relative to a common benchmark irrespective of the euro-area debtors' nationality. This is crucial to realizing the ideals of the common market and the common currency. It is also crucial from the perspective of financial stability policy. Banks would (with or without regulatory changes regarding sovereign debt) shrink their holdings of national sovereign debts and hold Euro Treasury debts as their safe assets instead.

The Euro Treasury would also provide the natural fiscal backstop that is still missing from the “banking union,” the declared objective of which was to “break the vicious circle between banks and sovereigns.” A single supervisory mechanism was established in 2014, entrusting the ECB as the principal supervisor for all banks in the euro area. And a single resolution mechanism became fully operational on January 1, 2016. The distinct trouble with Europe's “banking union” is that it does not really break the doom loop after all. No common fiscal backstop is in place for either deposit guarantee schemes or for situations in which “bail-in” of creditors proves insufficient to recapitalize banks and forestall contagion. In general, any losses arising from bank failures will still end up hitting national budgets, except for special circumstances under which the European Stability Mechanism (ESM) might directly inject equity into banks (the amount being capped at €60 billion). If banking union is a required complement to monetary union, so is fiscal union, featuring a sufficiently strong common fiscal backstop at the center (Pisani-Ferry and Wolff 2012; IMF 2013; Hellwig 2014; Veron 2015). The Euro Treasury is far more suitable than the ESM to play this role, as the Euro Treasury rests on a sounder funding basis. Needless to say, in the area of crisis management and resolution some discretion is inevitable.

Last, but not least, a full-blown euro-area transfer union is inevitable unless the prevention of persistent intra-area divergences and the buildup of imbalances is more successful in future. Fast wage increases in former East Germany left it uncompetitive, inflating the intra-German transfer union. Wage repression in (united) Germany then left euro partners uncompetitive, raising the

prospect of transfers, bailouts, or defaults. The German authorities have yet to grasp what I've dubbed "Germany's euro trilemma": Germany simply "cannot have it all it all—perpetual export surpluses, a no transfer / no bailout monetary union, *and* a 'clean,' independent central bank" (Bibow 2015).

Germany's notorious export surpluses are bankrupting its euro partners. To an extent the issue may be temporarily covered up and stored on the ECB's (and other quasi-fiscal) balance sheets, but ultimately transfers will have to take the form of debt restructurings of one type or another. Economically and socially, it would be less harmful to give away German export products for free in the first place. Politically, wage repression would become a hard sell if Germany's euro trilemma were better understood. Yet illusions will not sustain Europe's currency union forever.

8. CONCLUDING REMARKS

There is ample evidence that the ECB's monetary policy is afflicted with an antigrowth bias: the ECB is notoriously quick to hike, but extraordinarily slow to ease. This peculiar monetary policy asymmetry matches the stylized facts about the euro area's business cycle: the euro area fully participates in slowdowns, recessions, and crises, but has great trouble nourishing domestic demand-led recoveries. For an economy of its size, the euro area is remarkably export dependent.

The ECB is not the sole cause behind the euro area's mal-performance. The currency union's dysfunctional fiscal regime may be even more to blame. Ironically, the joint working of the two supposed anchors of stability have produced the "tax-push inflation" phenomenon: a sizeable upward distortion in headline inflation that occurred both in the mid-2000s and again in the crisis years. Yet the most critical flaw of all is the decoupling of central bank and treasury institutions in the euro currency union. The peculiar monetary-fiscal divorce has left all players and the euro currency union as a whole extremely vulnerable.

The ECB needs a treasury partner. We proposed a rudimentary fiscal union that is not a transfer union to fix this problem. The Euro Treasury would reboot and steady public investment, provide

a common yield curve of risk-free interest rates, and enable the decline in national public debt ratios to low and safe levels. That said, a transfer union will be all but inevitable unless persistent divergences in competitiveness (as witnessed for a decade leading up to the crisis, with Germany as the main culprit) and the corresponding buildup of intra-area imbalances are more successfully prevented in future. As a rule, no member state can err from the ECB's 2-percent stability norm for any length of time (see figure 1) unless this really is a necessary part in *restoring* its competitiveness, rather than underbidding its euro partners. As a legacy of past blunders in this regard, today Germany is forcing the euro currency union into outright deflation. The ECB was wrong to actually encourage such destabilizing conduct in the past.

As of today, the ECB has yet to wake up to the folly of its structural reform mantra that sees joint wage repression as a solution rather than the problem. Practicing QE in a currency union that—under its own cheerleading—is engaging in competitive wage deflation, the ECB resembles a self-punishing modern version of the Greek Sisyphus mythology. Only that Europe rather than the ECB suffers the actual punishment.

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