Discussion of Marcel Fratzscher's book „Die Deutschland-Illusion"

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The euro area suffers from the fact that there are too few cross-country debates on economic policy. Marcel Fratzscher's book "Die Deutschland-Illusion" has caught the attention of people in many European countries. While I do not share all the points made in the book, I welcome the debate on how the euro area responded to the crisis since 2009, how to avoid mistakes of the past and how to make the currency union more robust.

Let me also be clear on another topic: I am not here to distribute good or bad grades to governments. And since the book focuses on Germany, I would also like to stress that I believe that also the government in Berlin has acted in a constructive and a responsible manner throughout the crisis. No government in the euro area had a script for what happened in the past five years. We were confronted with the worst global economic and financial crisis in over 80 years. At the same time in Europe we had to deal with the unwillingness of some actors in euro area countries to comply with the necessary rules and constraints that membership in a currency union brings. Also, we had important institutional gaps in the initial design of EMU. All this made the euro area vulnerable. For some time the euro membership of some countries was in doubt, even the existence of the euro area as a whole came under threat. The disorderly exit of individual member countries or the disintegration of the euro area would have caused incalculable risks for financial stability in Europe and worldwide. Under these dramatic circumstances all governments and institutions lived up to their task.

In accordance with my European role at the ESM, I will concentrate my comments on the second half of Marcel Fratzscher's book, the section that deals with Europe and with Germany's role in Europe. He is right to point to the widespread feeling in Germany that somehow the country is victim and paymaster of the decisions that have been taken in response to the crisis. In this context often the creation of the ESM and certain ECB decisions are mentioned. I do believe that one of the merits of the book is that Marcel Fratzscher revisits these unfounded claims, contrasts them with the facts and comes to the clear result that they are wrong.

I would like to illustrate the wrong paymaster perception with an interesting counter-example. The ESM has a paid-in capital of €80 billion. This capital is our collateral. It is not used to finance our rescue loans, no taxpayer money is transferred to the programme countries. Rather the paid-in capital inspires investor confidence, it allows us to go the markets and issue bills and bonds at very low interest rates. All 18 euro area Member States contribute to the paid-in capital according to the size of their economy. As Germany is the largest economy, the largest part of the paid-in capital in absolute terms comes from Germany – roughly 27% or €21.7 billion. But interestingly, if you break down the contribution on a per-capita basis you see that Luxembourg, Ireland, the Netherlands and Finland all contributed more per capita to the ESM paid-in capital than Germany.

Let me turn to the European side of Marcel Fratzscher's book. In principle I agree with many points he makes: Yes, despite remarkable progress in overcoming the worst of the crisis, there are still fragilities. Yes, investment is the key variable for growth, not only in programme countries but also in countries that are currently doing well like Germany. Yes, disintegration of the euro area, as proposed by some academics and media, would have been the most costly way to proceed. And yes, we should start thinking about further institutional changes and reforms in the currency union to ensure a good long-term development of the euro area.

But there are also a number of points in the book that require more nuances and there are some that I take issue with. Let me start with the nuances. The book stresses the importance of the ECB's role in stabilizing the euro area. I am the first to praise the ECB for the decisive action it took throughout the crisis. And I want to add that I firmly believe that the ECB acted within the limits of its mandate in all the actions it took. Nevertheless, I am convinced that focussing only on the ECB neglects important changes in four other areas that contribute to the euro area's recovery. As the ESM is the fifth largest issuer in new issuances in euro after Germany, France, Italy and Spain I spend a lot of time talking to investors. They would not trust in the sustainability of euro area reforms if they believed it was all based on monetary policy alone.

The first of the four elements are reforms at the national level. Particularly in the five programme countries - Ireland, Portugal, Greece, Spain and Cyprus there are impressive efforts to consolidate and reform structurally. This is no coincidence because our loans always come with conditionality and only if the countries fulfill these conditions, the loan tranches are disbursed. The results are there: unit labour costs and current account deficits have decreased, competitiveness is restored and deficits are cut. In its recent survey "Going for Growth" the OECD shows that the programme countries are real reform champions among the OECD members. If these efforts continue, the countries can look forward to a sound and stable economy with growth and jobs. I don't underestimate the temporary social cost that comes together with these reforms.

The German labour market reforms in 2003 and 2004 have shown that such reforms do take time, which makes them politically difficult. But the German example also showed that eventually these reforms do pay off. The high growth figures we see now in Ireland, for example, and the start of a decline of unemployment levels in Spain, Ireland and Greece indicate this strategy is working in the programme countries. Inversely, of course, this also indicates that euro area countries that fail to undertake such reforms, and unfortunately there are some, run the risk of falling behind.

The second element are the new rules that we have decided collectively as a result of the crisis: Six Pack, Two Pack, the European Semester, new powers for the European Commission and enhanced monitoring possibilities for Eurostat are just some examples of what has been decided. If Member States respect these rules and coordination procedures and if the Commission uses its new powers appropriately then the euro area's weaknesses that were among the root causes for the past crisis will be eradicated.

The third element is the creation of the crisis resolution mechanisms, first the temporary EFSF in 2010, then the permanent ESM in 2012. Together they have a lending capacity of €700 billion and we have disbursed €232 billion to the five programme countries. Also, I would like to add that the presence of the ESM makes life easier for the ECB. It can now concentrate on being the lender of last resort for banks. The expectation to be the lender of last resort for governments has been taken off the ECB's shoulders.

The fourth element is Banking Union. New supervisory agencies have been set up. The Single Supervisory Mechanism (SSM) will look after more than 120 systemic banks in the euro area. A Single Resolution Mechanism (SRM) and a Single Resolution Fund (SRF) are currently being set up. Extensive bail-in rules will have the effect that the link between banks and sovereigns will be significantly weakened. If despite the bail-in and national government intervention European public money is needed, the ESM may recapitalize a bank directly, as a last line of defence.

I would argue that these four measures together with the ECB's monetary policy constitute an impressive and comprehensive crisis response. I am not saying all is well today. Reform efforts and vigilance need to continue. But I am disappointed by the book's assessment that "crisis policy as a whole must be considered as having failed". I do not think that this does justice to the results achieved by the programme countries, to the decisions taken among Member States and institutions to counter the crisis and to the hardships people in the programme countries were ready to endure.

Also, the book's judgement that Greek debt is not sustainable is something I do not share. With our loans and our lending terms we have created a new framework for Greece that makes the traditional debt sustainability analysis meaningless. We provide loans to Greece at ultra-low interest rates because we pass on our funding cost of just above 1.5% plus a very small margin to cover our operational cost. On top, Greece is currently benefitting from a 10 year interest rate moratorium. Also, the loan maturities are over 30 years. With these parameters in place, Greece has no debt overhang for at least a decade. These conditions provide the space for Greece to get into shape, start growing again and to honour its obligation once time comes. Hence I think it is wrong to argue that Greece needs another haircut. In this context, it is possible to calculate the solidarity Greece is receiving from it euro area partners as a result of such favourable conditions. For the year 2013 alone this represents 4.7% of Greek GDP, the equivalent to €8.6 billion in savings for the Greek budget. And it is very likely that the amount for 2014 and the years to come will be in a similar order.

To sum up: I do believe that we have created a framework that makes the euro area robust and sustainable provided the Member States and the institutions implement their decisions. Of course, it is good to look ahead. Therefore I have a lot of sympathy for the last part of Marcel Fratzscher's book that talks about Germany's responsibility and vision for Europe and that suggests a European agenda for Germany. From my perspective it would be important to focus on a few items. I would support the creation of a European finance minister or Commissioner that has the right to veto national budgets if they breach the agreed budget rules and if this budget creates negative spill-overs for the euro area. Also, I think contractual arrangements that are fed with a limited fiscal capacity in order to encourage structural reforms are a good proposal. These ideas are contained in the report "Towards a Genuine Economic and Monetary Union" written by the presidents of the Council, the Commission, the ECB and the Eurogroup. It seems clear that such innovations would require a limited EU treaty change. And I would hope that such an occasion would be used to integrate the ESM into the EU treaty. In my personal view the new treaty should be designed in a way that reflects the significantly deeper integration of euro area Member States compared to the EU and that includes enhanced democratic control. Obviously it is up to the governments to take such decisions.

I am aware of political and legal complexities all this may entail. A precondition for such a development is a constructive and informed public debate across Europe. It is the merit of Marcel Fratzscher's book that it is likely to encourage such a debate.