

Feuding inside the ECB?

Shortly before leaving office, ECB-head Mario Draghi is under fire internally. Are his opponents trying to prepare a renaissance of the «German» view on monetary policies? A column by Charles Wyplosz.

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Disagreements among well-intended people are perfectly normal, and this applies to the Governing Council of the ECB, which decides on monetary policy in the Eurozone. Some of its 25 members occasionally disagree, and in the past a few of them have even made their views publicly known, but what happened after the last decision goes much beyond normal disagreements.

[info 1R]In mid-September, the ECB adopted a set of measures designed to stop the decline in inflation further away from its stated objective. These measures all involve the non-standard policies invented by numerous central banks in the wake of the global financial crisis. They include negative interest rates, quantitative easing (QE), revealing the central bank's intentions quite far into the future, and more. They are credited for having prevented the world from undergoing a new Great Depression. These are the instruments that the ECB re-activated last month. What used to be nonstandard a decade ago is now seen part of every central bank's toolkit. Why all the fuss, then?

The honorable explanation is that the need to adopt a more expansionary stance at this stage is debatable. The case in favor of action rests on forecasts that indicate that an economic slowdown is on the way, which will bring inflation down. In fact, Germany is already oscillating on the verge of an outright recession. Normally, we would expect that the governments – especially the German one – use fiscal policy to prevent the situation from deteriorating further but they too have invented a new approach: do nothing that could create a budget deficit. This is definitely nonstandard but popular in Germany (and Switzerland). As a result, central banks have become the sole policymaking institutions to worry about recessions. Bound to deliver an inflation rate of close to but below 2%, the ECB cannot stay idle and continue to miss its objective.

Different traditions

The case against monetary policy action rests on various considerations. First, that inflation remains below the stated objective should be a source of concern, even after many years of continuous undershooting. Second, the nonstandard monetary policies carry adverse side effects such as a feeble remuneration of savings, which hit pension funds, excessive risk-taking by investors who look for better returns, fragilizing commercial banks, and more. Third, after years of negative interest rates and large QE, the effectiveness of nonstandard monetary policy is very much in doubt. Why then take action when it may not be needed and when adverse side-effects are well-identified?

There is no way of proving that one side of the debate is right and the other side is wrong, only time will tell, maybe. In such a situation, the ECB's Governing Council must decide on one or the other course of action, following its own process. Once it's done, the normal thing to do for those who lost the argument is to remain faithful to the institution that they have been appointed to serve. Instead, many of them publicly registered their disagreement and one member even resigned without explaining why.

The most striking aspect is that the public dissenters came from Germany, Austria and the Netherlands (and two Frenchmen let it be known that they had doubts about the effectiveness of the action). These three

countries are sometimes described as sharing a specific economic tradition, which relies more on markets than on governments, preferring rules to discrete public interventions. Although recent generations of economists from these countries now follow the same training as their counterparts elsewhere in the world (with few odd exceptions, of course) and share the same views, traditions remain and older generations are still actively promoting their views.

Resuming old fights

This divergence has been a mainstay of European integrations. It manifests itself particularly clearly in the areas of monetary and fiscal policies, precisely where governments intervene. The Germanic tradition is instinctively hostile to such interventions and only support them when they appear indispensable, whereas mainstream economists tend to encourage more policy activism.

Given the ambiguous case for action by the ECB this time, a disagreement within the Governing Board is not surprising. It is not surprising either that those who disagreed more strongly hail from Germany, Austria and the Netherlands. Sharp disagreements previously happened on several occasions. In fact, a number of German scholars have argued to the German and European constitutional courts that QE is illegal under the German Constitution. They lost, although an appeal is still under way.

The divergence of viewpoints is not new, it is well understood and it is an accepted implication of the monetary union. The reason why the latest events have attracted so much attention lies elsewhere. It has to do with the timing, at the very end of the presidency of Mario Draghi, but also with a second public attack by two former members from the Executive Board of the ECB and four former central bankers (two Germans, one Dutch and one French) whom the Financial Times unkindly described as «dinosaurs». They resume old fights that they – or their successors – lost.

A signal for Lagarde

How has the German view fared since the start of the euro? Up until the arrival of Mario Draghi, this view has mostly prevailed under the successive presidencies of Dutchman Wim Duisenberg and Frenchman Jean-Claude Trichet. When the former was appointed, he was widely seen as a German proxy. Jean-Claude Trichet always made sure to go along with the Germans, even at the price of letting the debt crisis simmer over two long years. Mario Draghi brought with him an intimate knowledge of up-to-date economic principles, and he acted accordingly. The «German view» was then promptly discarded as too ideological.

Just a few weeks preceding the end of a term in office, tradition has it that we only hear congratulatory tributes from colleagues. Those who have found it necessary to break with tradition this time must have felt the urge to send a number of signals. They may want, indeed, to express the view that the Presidency of Mario Draghi has not been successful. Or even central bankers are normal human beings who harbor grudges, and they find it convenient to express them at this special time, if only because they have long been waiting for this moment to come.

Alternatively, they are looking forward. They may be preparing a renaissance of the German view. They may consider that this is a propitious moment to let Christine Lagarde know what a number of people believe. There are other ways to convey this message though, both more effective and more elegant, than by attacking an enormously successful policymaker whose legacy with bringing the debt crisis to its end has become a textbook demonstration of the flaws of the German view. In a way, these attacks are a sign of despair. The future President of the ECB is known for her charm and her diplomatic talent, none of which should be confused with weakness. She is also known for consulting widely but also for having little patience for ideological battles. If anything, the protesters have harmed their position.