

Brunnermeier, Markus; James, Harold; Landau, Jean-Pierre

**Conference Paper**

## The Euro and the Battle of Ideas

Beiträge zur Jahrestagung des Vereins für Socialpolitik 2016: Demographischer Wandel -  
Session: Monetary Integration, No. C17-V1

**Provided in Cooperation with:**

Verein für Socialpolitik / German Economic Association

*Suggested Citation:* Brunnermeier, Markus; James, Harold; Landau, Jean-Pierre (2016) : The Euro and the Battle of Ideas, Beiträge zur Jahrestagung des Vereins für Socialpolitik 2016: Demographischer Wandel - Session: Monetary Integration, No. C17-V1, ZBW - Deutsche Zentralbibliothek für Wirtschaftswissenschaften, Leibniz-Informationszentrum Wirtschaft, Kiel und Hamburg

This Version is available at:

<https://hdl.handle.net/10419/145852>

**Standard-Nutzungsbedingungen:**

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

**Terms of use:**

*Documents in EconStor may be saved and copied for your personal and scholarly purposes.*

*You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.*

*If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.*

# The Euro and the Battle of Ideas



Markus K. Brunnermeier, Harold James and Jean-Pierre Landau

This draft: 9 February 2016

Newest draft: Please email [markus@princeton.edu](mailto:markus@princeton.edu)

## Contents

Chapter 1: Introduction.....	5
PART I: Power Shifts and German-French Differences	
Chapter 2: Power Shifts.....	14
Lethargy of European Institutions.....	15
The First Power Shift: From Brussels to National Capitals .....	16
The Second Power shift: To Berlin-Paris and Ultimately to Berlin.....	22
After the Power Shift .....	26
Conclusion .....	30
Chapter 3: Historical Roots of German-French Differences.....	31
Cultural Differences .....	31
Federalism versus Centralism .....	33
Economic Structures: Mittelstand versus National Champions .....	37
Collaborative versus Confrontational Labor Unions.....	39
Historical Inflation Experiences .....	41
Chapter 4. German-French Differences in Economic Philosophies.....	43
Fluid Traditions: Switch to Opposites.....	43
German Economic Tradition .....	45
French Economic Tradition .....	52
International Economics.....	58
PART II: Maastricht's Ghost	
Chapter 5: Rules versus Flexibility: Time-Inconsistency and ECB Independence .....	65
Rules as Belief Management vs. Flexible Crisis Management.....	66
External Commitments: Gold standard, Currency Pegs and Boards .....	68
Reputation .....	69
Delegation to Independent Institutions & Game of Chicken .....	71
Policy recommendations .....	72
Chapter 6: Liability versus Solidarity: No Bailout Clause & Fiscal Union .....	74
No Bailout Clause.....	75
Fiscal Unions.....	76
Eurobonds .....	84
Policy Recommendations .....	87
Chapter 7: Solvency versus Liquidity .....	89
Build-up of Imbalances & Naked Swimmer .....	90
Solvency .....	90

Liquidity .....	91
Solvency or Liquidity? Crossing the Rubicon.....	95
Sovereign Debt Restructuring and Insolvency Mechanism.....	96
Fiscal Push: Increasing Scale and Scope of EFSF and ESM.....	97
Monetary Push .....	100
Policy Recommendations .....	102
Chapter 8: Austerity versus Stimulus .....	103
The Fiscal Multiplier Debate .....	104
The Output Gap vs. Unsustainable Booms Debate .....	108
The Political Economy of Structural Reforms.....	110
The European Policy Debate on Austerity vs. Stimulus .....	112
Lessons and Policy Implications .....	116

## Part III: Maastricht's Stepchild

Chapter 9: The Role of the Financial Sector .....	118
Traditional Banking .....	119
Modern Banking and Capital Markets.....	122
Cross-border Capital Flows and Interbank Market.....	125
Chapter 10: Financial Crises: Mechanisms and Management .....	130
Financial Crisis Mechanism.....	131
Crisis Management: Monetary Policy .....	139
Crisis Management: Fiscal Policy .....	145
Ex-Ante Policy: Preventing a Crisis .....	153
Chapter 11: In Search of the Minimal Union: Banking Union, Safe Assets & Exit Risk .....	156
Banking in a Currency Union.....	157
Safe Assets: Flight to Safety Cross Border Capital Flows Problem.....	165
Redenomination and Exit Risks.....	168
Policy Conclusion .....	174

## Part IV: Others' Perspectives

Chapter 12: Italy.....	175
The Fiscal Union and Convergence.....	176
The Current Account and the Nation-State .....	178
The Dual Labor Market.....	178
Politics and Decline .....	179
Chapter 13: Anglo-American Economics and Global Perspectives .....	183
Diverging Traditions.....	184
The Politics of Looking for Recovery: The U.S. ....	191
The Politics of Thinking Outside Europe: The U.K. ....	196
The Global Perspectives: China and Russia.....	203

Conclusion .....	208
Chapter 14: The International Monetary Fund (IMF) .....	209
IMF's Philosophy and Crisis Management .....	210
The IMF's Initial Involvement in the Euro crisis .....	215
The IMF and the Troika .....	219
A Change in IMF's Leadership .....	222
Loss of Credibility: Muddling through, Delayed Greek PSI.....	224
Chapter 15: European Central Bank (ECB).....	230
The ECB before the Crisis: Institutional Design and Philosophy .....	231
The ECB's Successes and Defeats during the Onset of the Crisis .....	240
The ECB and Conditionality .....	245
Lending and Asset Purchases Programs .....	253
Single Supervisory Mechanism (SSM) for European Banks.....	270
Taking Stock: Where does the ECB Stand? .....	273
Chapter 16: Conclusion: Black and White or Twenty Eight Shades of Grey? .....	275
Acknowledgements.....	286

## Chapter 1: Introduction

October 10, 2010 was a day that changed European politics. The German Chancellor Angela Merkel had travelled to the Normandy seaside town of Deauville to discuss the European crisis with France's President Nicolas Sarkozy. Press photographs show them in dark raincoats, strolling on the wet and deserted autumnal boardwalk, Sarkozy gesticulating argumentatively and Merkel apparently responding with a look of blank incomprehension. In fact, after a moment in which it looked as if contrasting German and French visions of the world were bound for a head-on collision, they reached a dramatic compromise: Germany would loosen its approach to rules and make concessions to France, if France would in return agree to "an adequate participation of private creditors." Chancellor Merkel – who enjoyed substantial public support in her country – believed that banks had been responsible for the unwise extension of credit and should bear the cost of it. An end had to be put to the bailout mentality that had followed the global financial crisis of September 2008, the failure of Lehman and the rescue of AIG. The basic elements in the Franco-German agreement had been achieved, and kept secret, two weeks before, during an informal conversation between the two leaders at the margin of a NATO Summit in Brussels.

Other European leaders were stunned when they learnt of the outcome on their Blackberry mobile devices. The head of the European Central Bank immediately thought that the agreement was a mistake, and U.S. Treasury Secretary Tim Geithner was enraged by the proposal, warning European policymakers that "if you're going to restructure Greece, [...] you have [to have] the ability to in effect protect or guarantee the rest of Europe from the ensuing contagion."<sup>1</sup> Markets shared this sentiment. Immediately after Deauville, interest rates on periphery government bonds shot up. Germans welcomed the imposition of market discipline on the periphery in Europe, while French commentators viewed the spike in rates as unjustified from a fundamentals standpoint — a pure liquidity effect.

The episode first of all made clear that differences in the German and French visions of appropriate economic policy were at the heart of the difficulty of finding a response to Europe's financial crisis. The incident also highlighted how much power in Europe had shifted away from the European Union institutions in Brussels – the Commission and the European Council – and towards two big nation states: countries that found it hard to talk a common language.

The Euro crisis has led to the outbreak of a war of ideas in the European continent and to a seismic shift of power within Europe. Starting with fiscal problems in one of Europe's smallest economies, Greece, in late 2009, a long simmering battle over the appropriate economic philosophy and future design of the European Union broke into the open. It is a struggle between northern – above all German – and what are sometimes called southern – but above all French – theories. The debate is not limited to French and Germans: Finns and Austrians and sometimes Slovaks and Poles behave as if they are more Germanic than the Germans; and France is often seen as a

---

<sup>1</sup> Peter Spiegel, "Draghi's ECB Management: The Leaked Geithner Files," *Financial Times*, November 11, 2014. Last accessed January 4, 2016 from <http://blogs.ft.com/brusselsblog/2014/11/11/draghis-ecb-management-the-leaked-geithner-files/>

champion of a Mediterranean Europe. But in practice the clash is often treated as if it were a war of ideas fought out across the river Rhine. Italy is divided between a north that looks intellectually and economically like Germany and a south in which there is more sympathy for French-style theories. The French and German positions outlined here should be understood as “ideal types”, a concept developed by the sociologist Max Weber to better understand problems, debates and institutions by thinking in terms of sharply differentiated features. Weber, and every good subsequent analyst, knew well that reality was messy, but thought that conceptual clarification could bring a greater realization of the roots of social peculiarities.<sup>2</sup>

It is this war of ideas that lies at the heart of our book. Our main aim is to provide an explanation of the long term historical, intellectual and cultural roots of the contrasting German and French economic philosophies. One might think that each country exclusively fights for its own material interests. Such a narrow perspective overlooks an even more important aspect: interests are interpreted through the lens of ideas, or visions. Some countries have developed their own economic traditions and schools. Given their historical paths, different countries in Europe follow different economic philosophies and derive different policy descriptions for how to respond to crisis events. Previously these differences were always taken for granted, but glossed over and never thoroughly discussed. The European integration process – arguably one of the most successful peace initiatives in history – was characterized by a tendency to be panglossian in the face of crisis. Indeed, differences between countries were often so engrained in national policymakers’ thinking that mutual incomprehension ensued. Policymakers even used the same word for different concepts. Thus “economic governance” for Germany meant convergence around a common stability culture, while for France it meant common initiatives to direct economic development. Similarly, Germans interpreted the Euro as an improved version of the old Exchange Rate Mechanism – built around the virtues of the Deutschmark – while the French saw the Euro as a new global currency and conduit for more effective Keynesian stimulus policies.<sup>3</sup>

Of course, there are also straightforward differences in *interests* between European countries, including between France and Germany. But interests are often seen through the lens of ideologies. The difference between European countries is often reduced by some analysts to a simple contest between creditors and debtors, based on net asset positions.<sup>4</sup> Since the 1960s, Germany has built up a substantial net creditor position via sustained current account surpluses. France has occasionally had surpluses, but interspersed with substantial deficits. So it might be

---

<sup>2</sup> His standard example of the use of the concept of “ideal type” was the economist’s assumption of rational (ends rational: *Zweckrational*) action, even though in the real world it was obvious that all sorts of influence – including traditions, affects, mistakes and the influence of non-economic ends – would influence economic actions. Weber insisted that an abstraction that allowed a coherent sense was necessary, and analogous to some scientific experiments which also would not work perfectly except if conducted in an absolute vacuum. (Max Weber, *Wirtschaft und Gesellschaft: Studienausgabe*, Stuttgart: J.C.B. Mohr (Paul Siebeck), 2014, pp.13-14.)

<sup>3</sup> Shahin Vallée, “How the Greek Deal Could Destroy the Euro,” July 27, 2015. Last accessed January 4, 2016 from <http://www.nytimes.com/2015/07/28/opinion/how-the-greek-deal-could-destroy-the-euro.html>

<sup>4</sup> See for instance Jeffrey A. Frieden, “The Political Economy of Adjustment and Rebalancing,” paper at JIMF-U.S.C Conference on Financial Adjustment in the Aftermath of the Global Crisis, Los Angeles, April 18-19, 2014; see also Jeffrey A. Frieden, *Currency Politics: The Political Economy of Exchange Rate Policy* (Princeton: Princeton University Press, 2014).

thought that Germany (and creditors in general) would focus on strict debt repayment, even if it means squeezing the pips out of debtors, and that it would prefer low inflation to increase the real value of nominal debt. By contrast, France (and debtors in general) would be amenable to debt forgiveness, or higher inflation to erode the real value of debt. But this line of argument is open to objections. The net asset position as the sum of the net flows is an accounting identity for countries, but this masks much larger gross flows and an accumulation of a wide variety of personal and institutional positions: there may be powerful and substantial debtors in the net creditor countries.<sup>5</sup> Equally important, a wise creditor will normally hope that the debtor is prosperous and dynamic, so as to be able to repay debt in future. Squeezing the pips may reduce the chances of being repaid fully. A debtor will also be aware that non-repayment or default will damage future chances of borrowing for productive purposes. So the judgment calls on both sides depend on ideas about the other side: is debt growth-enhancing (good) or a sign of profligacy (bad)? These are ideological judgments: as Weber put it in a famous analogy: “Not ideas, but material and ideal interests, directly govern men’s conduct. Yet very frequently the ‘world images’ that have been created by ‘ideas’ have, like switchmen, determined the tracks along which action has been pushed by the dynamics of interest.”<sup>6</sup>

The process of European integration is full of the same kinds of misunderstandings and misinterpretations that often characterize relationships between men and women. According to an American popular psychologist who wanted to provide a “practical guide for improving communication and getting what you want in your relationships,” men and women are from different planets.<sup>7</sup> The book was wildly successful, with seven million copies sold. His title was adapted to international politics by Robert Kagan, who argued that Americans were from Mars and Europeans from Venus. “It is time,” he said, “to stop pretending that Europeans and Americans share a common view of the world, or even that they occupy the same world.”<sup>8</sup> Europe has now discovered that it has its own version of mutual incomprehension.

The basic elements of the contrasting philosophies can be delineated quite simply. The northern vision is about rules, rigor, and consistency, while the southern emphasis is on the need for flexibility, adaptability, and innovation. It is Kant versus Machiavelli. Economists have long been familiar with this kind of debate, and refer to it as rules versus discretion.

Some more specific policy preferences follow from the general orientation. The rule-based approach worries a great deal about the destruction of value and insolvency, and about avoiding bailouts that will set a bad example and encourage inadequate behavior among other actors (economists call this the moral hazard problem). The discretionary approach sees many economic issues as temporary liquidity problems that can be solved easily with an injection of new lending.

---

<sup>5</sup> Claudio Borio and Piti Disyatat, “Capital flows and the current account: Taking financing (more) seriously,” BIS Working Paper 525, 2015.

<sup>6</sup> Max Weber, “The Social Psychology of World Religions,” in *From Max Weber: Essays in Sociology*, ed. Hans H. Gerth and C. Wright Mills (London: Routledge and Kegan Paul, 1948), p. 280.

<sup>7</sup> John Gray, *Men are from Mars, Women are from Venus: A Practical Guide for Improving Communication and Getting What You Want in Your Relationship* (New York: HarperCollins, 1992).

<sup>8</sup> Robert Kagan, *Of Paradise and Power: America and Europe in the New World Order* (New York: Alfred A. Knopf, 2003).



Here the provision of liquidity is costless: there is no bailout and no incurred loss; in fact, the knock-on effects make everyone better off. There are, in this vision, multiple possible states of the world – multiple equilibria – and the benign action of governments and monetary authorities can shift the whole polity from a bad situation into a good one. To this, the long-faced adherents of the “moral hazard” view point out that costs will pile up in the future from the bad example that has just been set.

ECB President Mario Draghi’s “whatever it takes” proclamation on July 26, 2012 in London – just before the opening of the Olympic Games – was after Deauville the second watershed moment in the Euro crisis. Mario Draghi’s promise that the ECB is willing to do “whatever it takes” to save the Euro later led to the creation of the so-called “Outright Monetary Transactions” (OMT) program, under which the ECB would stand ready to buy government debt of distressed countries (under some conditionality). Proponents of the “liquidity” view felt vindicated by the fact that the tide had turned and that interest rates in the peripheral countries significantly declined without any outright transactions taking place. The implicit support of Angela Merkel and Finance Minister Wolfgang Schäuble was crucial to the effectiveness of Mario Draghi’s promise. However, Conservative Germans challenged the ECB’s OMT program in the German constitutional courts and the European Court of Justice. For them, interest rates had subsided only because the ECB implicitly guaranteed peripheral government debt. In the end, the credibility of the measure hinged on the interpretation of whether or not it was consistent with the German vision.

The rules principle emphasizes the importance of solidity – of not living beyond one’s means. Charles Dickens in the novel *David Copperfield* has Mr Micawber tell David: “Annual income twenty pounds, annual expenditure nineteen and six, result happiness. Annual income twenty pounds, annual expenditure twenty pounds ought and six, result misery. The blossom is blighted, the leaf is withered, the God of day goes down upon the dreary scene, and – and in short you are forever floored. As I am!” The southern or French approach, by contrast, emphasizes social solidarity. Paragraph 21 of the 1793 Declaration of the Rights of Man and the Citizen – the ultimate statement of the ideals of the French Revolution – stated that “Public relief is a sacred debt. Society owes maintenance to unfortunate citizens.” The southern view also tried to extend the principle of solidarity across national frontiers, a move that the northerners resisted. In general, the rule-based view is concerned with price stability; the discretionary approach embraces the idea of managing the economy.

Almost all contemporary commentators have recognized the chasm between the two competing ideas. Many treat it as a product of plain stupidity and ignorance on one side: Paul Krugman talked about a “Dark Age of macroeconomics” in which the good lessons of the Greeks and the Romans had been countermanded by the obscurantist barbarians (from the north!) who overrun Mediterranean civilization.<sup>9</sup> The second interpretation is that these preferences represent deep historical traditions, cultures, and memories – so deeply rooted that they cannot be erased by the persuasive powers of superficial rationality and logic. In particular, Germans were so seared by

---

<sup>9</sup> Paul Krugman, (2009, January 27), “The Conscience of a Liberal,” *The New York Times* (last accessed January 4, 2016). Retrieved from [http://krugman.blogs.nytimes.com/2009/01/27/a-dark-age-of-macroeconomics-wonkish/?\\_r=0](http://krugman.blogs.nytimes.com/2009/01/27/a-dark-age-of-macroeconomics-wonkish/?_r=0)

the experience of catastrophic hyper-inflation in the early twentieth century that ninety years later they repeat a meaningless mantra.

But wait a moment: Krugman's Dark Age is about the revival in the twenty-first century of the principles of Jean-Baptiste Say, a nineteenth century economist – from France! In fact, in the nineteenth century, most French (and for that matter Italian) economists were, like Say, classical liberals who mentally inhabited a rule-based world. On the other side of the Rhine, in Germany, economists and politicians didn't care much about rules – seeing them rather as a hypocritical device used by English free traders to impose their preferences on a backward continent. In other words, for a long time – basically until the middle of the twentieth century – the French were rule-obsessed moral hazard fiends, and the Germans were profligates who thought that fiscal spending was the key to prosperity and success. So it cannot be true that the economic cultures are deeply and irrevocably entrenched.

As will be explained later, the French and German view of rules reversed as a result of a historical crisis of unprecedented severity: the Nazi dictatorship, the Second World War, and the fall of France in 1940. Germans learnt that they needed rules in order to restrict the possibility for arbitrary government action; while the French thought that their political system under the prewar Third Republic had too little fiscal, military and intellectual flexibility in dealing with the Nazi threat. Later, the new members of the EU from formerly communist central Europe would learn a similar lesson to the Germans after 1945: that good government and the limitation of corruption and political abuse required strict rules.

This book sets out a rather different interpretation of the impact of clashing economic cultures. First, that though there are indeed different national ways of thinking about economics, they are changeable when dramatic new circumstances arise. Second, up to now – in the context of a new crisis – that rethinking has not proceeded very far. On the contrary, countries are following on the whole an approach of “business as normal” – digging trenches around established intellectual or theoretical propositions. The rational business of negotiation strategies developed in the course of the European crisis intensified rather than resolved the clash of cultures. As the relentless logic of events went on, the French appeared ever more French and the Germans ever more German.

The Maastricht Treaty – the document that provides the legal framework of the Euro – lies at the root of the current problems. It assumed too simply that price stability was sufficient to ensure financial stability; and that fiscal policy had no role to play in the provision of price stability. It allowed French and German thinkers and politicians to operate with incompatible visions of economic governance. In short, it was about what the treaty labeled “European Union” – but the Europeans looked as if they did not really intend or understand the concept of “union”.

For some, Europe had now become a new sort of political entity, a postmodern, twenty-first century state in which the traditional principle of national sovereignty no longer applied. The treaty looked like a detailed and helpful itinerary to “ever closer union.” But others believed that Maastricht was simply a treaty arrangement which could be broken if conditions changed. Customary international law includes a clause known as *rebus sic stantibus*, things being as they are, that allows treaties to be broken if fundamental conditions change. There was also another ambiguity about Maastricht: all members of the European Union, with the exception of the U.K.

and Denmark which negotiated opt out clauses, were committed to join the currency union when the accession criteria were met. The result was that there was a European Union that was separate in terms of membership from the narrower Euro area. That separation gave rise to a debate about multi-speed Europe. In 1994 in the immediate aftermath of Maastricht, two German Christian Democratic politicians, Karl Lamers and Wolfgang Schäuble, issued an influential paper setting out the idea of a Europe of “varying geometry” that relied on a “hard core” provided by France and Germany.<sup>10</sup>

For many politicians, especially for former German chancellor Helmut Kohl, economic aspects did not play a major role in the origins of the Euro area. Rather, the currency union was a high-minded European political project that went way beyond economic realities. It was needed to stop the recurrence of war between France and Germany. Proponents of the “peace project theory” ignore that one does not need a currency union to improve relations with neighbors. Even worse a malfunctioning currency union might even lead to civil war, as the American economist Martin Feldstein had warned in the late 1990s.

The debate about interests produced a much more sinister view of the origins of the Euro – a conspiracy theory about a vicious deep-seated German masterplan. Since Germany has typically a lower rate of wage inflation than France and much lower rates than the Mediterranean countries, a locked currency would guarantee increased export surpluses, at the price of misery elsewhere. In this manner, a German grasp for European economic primacy would succeed at the end of the twentieth century and in the new millennium where a similar German military plan had failed one century earlier. Some of the earliest exponents of the notion that the currency was a German instrument of dominance were British, notably the former U.K. Chancellor of the Exchequer Denis Healey, but now it is circulating widely, above all in southern and peripheral Europe. In the Euro crisis, southern Europe began to talk incessantly about German hegemony. Italian Prime Minister Matteo Renzi complained that “Europe has to serve all 28 countries, not just one.”<sup>11</sup> This view seems implausible, as lending and subsequently plunging one’s neighbors into national bankruptcy is not a good way of building any kind of stable prosperity.

A mirror image of the idea of a German masterplan is provided by the equally often expressed claim that the Euro was the price that France exacted in 1990 for its agreement to German unification. President François Mitterrand, according to this version, wanted to put an end to a Europe that was controlled monetarily by the Bundesbank. He thought that a monetary union would go hand in hand with a “gouvernance économique” in which France could project and extend its statist orientation to encompass the whole of Europe. Monetary union, in short, would be the Trojan horse that would carry French thinking into the heart of all of Europe. So in the Euro crisis, German commentators started to talk about a dictatorship of southern Europe, or to complain that the ECB had been taken over by south European government officials.

---

<sup>10</sup> Karl Lamers and Wolfgang Schäuble, Überlegungen zur europäischen Politik, September 1, 1994.

<sup>11</sup> James Politi, Financial Times interview: Matteo Renzi, Financial Times, December 22, 2015.

In the end, the story of monetary union is one about dealing with imbalances and fiscal and monetary adjustments in the least politically costly way possible. As such, the monetary union reflected – and failed to resolve – many of the differences in economic philosophy between the French and the German sides. These differences came to the fore in the recent crisis.

We therefore examine in Part II of the book, titled “The Ghost of Maastricht”, the major battle grounds and ideological difference in economic thinking that resurfaced again. They had already played a major part during Maastricht negotiations in the late 1980s and early 1990s, and the global financial crisis rekindled the intra-European debate. The different visions of the economy, the clash of a preference for rules with a preference for discretion, affected the way the interests of the different countries were presented in policy debates. The creditor and debtor countries played a strategic game: both reckoned that the other side could not have an interest in letting the system collapse, and so a game of not yielding and moving closer to the brink looked plausible and attractive. In this way, the interaction of ideas and strategic reflection on interests brought Europe to the edge of the abyss. When it appeared that Germany’s constitutional court – which delivered ponderous rulings on whether rescue packages were in conformity with German laws and constitutional principles – was giving the German government a reason for taking a more intransigent line, constitutional courts in Portugal and Greece started their own brand of activism, and handed down rulings that austerity measures were unconstitutional.

Part III, “Maastricht’s stepchild”, explores the problem of dealing with financial instability – an important omission in the Maastricht Treaty. It outlines the shift in the financial architecture and how the banking union tries to reduce financial instability in the monetary union. Prime examples of the dangerous dynamics of financial stability in the context of monetary union are Spain and Ireland – two fundamentally fiscally sound countries thrown into crisis by their own banking systems.

The third watershed moment in the Euro crisis after Deauville and Draghi’s London speech was the European debate over Cyprus in spring 2013. The German discussion was dominated by the perception that a great deal of the liabilities of the Cyprus banking system consisted in assets of Russian oligarchs, which constituted a possible criminal or even security threat, and hence required no special protection by European governments. For Berlin, there was little that constituted systemic risk in the Cyprus situation, and German officials complained that “if Cyprus is systemic, then everything is systemic”. By contrast, many policymakers in France, but also in Italy and Spain, feared that penalization of Cypriot depositors might lead to a bank run in other countries (including their own).

The Cyprus crisis changed European’s attitude towards bailouts. The new chair of the Eurogroup, Netherlands Finance Minister Jeroen Dijsselbloem, spoke of the Cyprus approach as offering a “template.” Even outside Europe, it looked like an attractive solution to the problems created in the wake of the financial crisis. For instance, the influential Governor of the Bank of Canada Mark Carney deduced that his country should move away from bailouts, and in May 2013 the Canadian budget launched a “bail-in regime.” In Europe, the bail-in principle was integral to the banking union proposals. Critics argue that this undermines the transaction role of money, as demand deposits should remain informationally insensitive and argue for higher equity cushion. As the banking union proposals were elaborated, an ever decreasing number and type of assets were

liable to the bail-in procedure. The bail-in principle suffered another hit in late 2015, early 2016. Italian banks had sold risky subordinate bonds to Italian retail investors with little financial knowledge. As some banks got into trouble, these investors lost large parts of their retirement savings, leading social hardship – tragically one pensioner even committed suicide.

While Parts I-III focus on the German-French differences, Part IV collects various other perspectives on the crisis. Chapter 12 examines Italy, one of the six founding members of the European Economic Community. Italy largely stood by on the sidelines of the Franco-German debate and long stood as an example of the problems of inadequate economic integration in a common political area. Its historic North-South conflict was a microcosm of tensions within the currency union – and perhaps an indication that fiscal transfers alone are incapable of resolving these problems. In terms of economic philosophy, Italian economists were split between the major schools of thought outlined above as “German” and “French.” Postwar Italy was initially made by economic liberals such as Luigi Einaudi, an economics professor who became the first postwar president of the Banca d’Italia and then (in 1948) President of the Republic. Einaudi’s emphasis on the importance of rules had a clear similarity to the thought of the German *Ordo-Liberals*. Keynesianism was at first best represented by two famous Italian economists who had fled from Mussolini’s Italy: Piero Sraffa at Cambridge University in the U.K., who tried to combine Keynesianism and Marxism, and Franco Modigliani at MIT in the U.S., one of the main drivers of the new Keynesian synthesis.

Chapter 13 starts with an outline of Anglo-American economic thinking. Overall, Anglo-American and French philosophies have many parallels, in particular deep roots on Keynesian thinking and an emphasis of liquidity over solvency considerations. Notably, whenever U.S. or U.K. politicians lectured EU officials about optimal economic policy, they almost always sided with the French liquidity interpretation – favoring big bazooka and bailout solutions. Both the French and the Anglo-American interpretations of the Euro area crisis stress the importance of fiscal union as a necessary stepping stone for smooth functioning of a common currency union, although the British and the Americans regarded fiscal union primarily from an outsider perspective. However, the Anglo-American and French philosophies also differ in important ways. First, Anglo-Americans are much more skeptical about the general desirability of government intervention than the French. Both agree that the government can and should intervene in a deep crisis — but the French are much more sympathetic towards a government that coordinates economic activity all the time, which includes the involvement of the government in the financial sector. Second, debt in the Anglo-American approach is a contingent construct. That means there is some flexibility that depends on particular circumstances. In times of hardship debt is not repaid and bankruptcy laws enable a new start. The Continental European interpretation of debt and the need for repayment is, in contrast, much more stringent. Third, French policymakers push for an actively managed international monetary system and see the Euro as an alternative to the long-lived hegemony of the dollar. Chapter 14 also covers the global dimension of the crisis, paying particular attention to the Chinese and Russian attitudes towards the troubles of the Euro area.

The International Monetary Fund’s economic philosophy is discussed in Chapter 14. The IMF is open for debt restructuring in order to make debt burden sustainable. The IMF also brought much needed expertise and external discipline to the table. The IMF’s conditionality and focus on

structural reforms aligns with Germany's view. On the other hand, in terms of fiscal stimulus the IMF took the French view of relaxing fiscal rules and expanding government spending. The IMF was part of the brief and apparently successful interlude of cooperation in fall 2008 and spring 2009 in the intermediate aftermath of the U.S. subprime crisis. Complacency about governments' capacity to cooperate led to a resurgence of zero-sum thinking – a style of politics that had last been seen during the Great Depression.

In Chapter 15 we turn to the analysis of the European Central Bank (ECB) – the only European institution whose power increased dramatically during the crisis, but an institution (like central banks all over the world) also fundamentally changed through the adoption of non-conventional monetary policies and a new mandate on bank supervision. The most important game of chicken in the Euro crisis occurred between the ECB and the national governments. The ECB was aware that if it were too generous, national governments would falter and stall in their reform efforts; and the national governments also knew that if they did nothing and there were a crisis, ultimately the ECB would have the responsibility of finding some way out: it would be forced to be generous. In terms of debt restructuring, the ECB's economic stance is to resist it. Their main argument is that it would undermine the role and function of money. As a consequence, the ECB also has a tendency to treat problems as temporary liquidity rather than solvency problems.

Our book wants to highlight these differences by looking at the crisis through various lenses: the Teutonic lens and the Latin lens. The aim is to analyze differences in the hope of finding a common ground, or at least a better understanding of each other's positions – and possibly thereby speeding up the crisis response.

In the following pages, the three of us discuss how this common language can be achieved. We share different national origins – German, British, French – as well as different intellectual pedigrees, in economics, in economic history, and in public service. The following sections deal with the fundamental economic dilemmas that exist everywhere, have been magnified in the wake of the financial crisis, and are still greater in the complex situation created by a currency union; with the long-standing differences in intellectual and political traditions respecting economic life; and in the way that the policy discussions reflected (and their outcomes shaped) by both constraints. When we started this collaborative enterprise, we were convinced that if we could overcome all our differences, such a reconciliation might occur on a European level. We didn't want to despair, and we don't think that Europe should either.