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Book Review

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Book review

Heine, Michael and Hansjörg Herr (2021): *The European Central Bank*, Newcastle upon Tyne, UK (208 pages, Agenda Publishing, hardcover, ISBN 978-1-78821-294-6; softcover, ISBN 978-1-78821-295-3; ebook, ISBN 978-1-78821-296-0)

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In 2020, *EJEEP* published a special issue on ‘The euro at 20 – macroeconomic challenges’ with contributions by Bénassy-Quéré (2020), Bibow (2020), Zezza (2020), Bofinger (2020) and Constâncio (2020), who critically reviewed the establishment, evolution and current state of the euro area. The monograph at hand by Michael Heine and Hansjörg Herr offers a rich fundus of institutional, empirical and analytical information in historical perspective that is necessary to understand such debates on monetary policies in the euro area. Moreover, the two authors present their own post-Keynesian view that stresses endogenous money creation and coordination of macroeconomic policies. Both authors are professors emeriti of two Berlin universities which still have a significant number of heterodox professors, although pluralism is under pressure there, too (cf. the interview in *EJEEP* issue 18(2) with Hansjörg Herr, see Hein 2021: 114).

The book, as its title indicates, focuses on the monetary policies of the European Central Bank (ECB) but embeds this in a regime-oriented approach which both authors have spelled out with co-authors in earlier publications (Heine et al. 2006; Herr/Kazandziska 2011). The concept of macroeconomic regimes refers to relatively stable country-specific patterns rooted in economic constellations, institutions, and world views, and their interwoven development over time. In my view, this approach is extremely helpful to illustrate in a systematic way the often dysfunctional interplay of policies at European level and between supranational and national level and the conflict-laden setting of the European Union (EU) and the euro area since the Bretton Woods era.

After a short introduction on the governance structure of the EU and the euro area (chapter 1), Heine and Herr examine history and evolution of the monetary union and the role of the central bank in chronological order. By pointing to the crisis-prone exchange-rate system after the Bretton Woods period they explain in chapter 2 the pressure on European governments to establish a monetary union despite all economic and ideological divergences. Chapter 3 then reflects upon the flawed foundations of the forthcoming monetary union enshrined in the Maastricht Treaty and later the Stability and Growth Pact because both treaty and pact created an independent central bank without the allowance to finance public households and without a fiscal counterpart at supranational level. The next two chapters contrast the institutional structure of the ECB and its policy tools with requirements for a stable monetary union. According to Heine and Herr, the central bank is neither well equipped to fight deflation nor is its function of a lender of last resort uncontested. Moreover, both a fiscal capacity that balances divergent economic developments among the member states and a coordinated wage policy is

lacking. In what follows, the authors criticise in chapter 6 the later-revised two-pillar strategy of the ECB with its strong focus on the development of M3, against the background of their own view of endogenous money derived from Marx and Keynes. The ensuing chapters shed light on historical phases in the evolution of the monetary union. In an empirically rich approach, they characterise the years before the financial market crisis, the Great Recession, the turning point for monetary policies in 2012, and end with the recent pandemic. This economic analysis of the historical periods is interrupted by two chapters on the unfolding and current state of fiscal rules at supranational level and on financial supervision. Chapter 11 provides a good but descriptive overview on the fiscal setting, though adds little analytically to the previous chapters; chapter 12 on micro- and macroprudential supervision and financial market regulation also offers a concise overview but does not put the ECB and its (limited) role regarding this supervision into the context of this chapter.

Often Heine and Herr come to similar conclusions as the authors of the special issue mentioned above: The ECB, misguided by monetarist and Wicksellian ideas, was not very successful at the beginning when it had to deal with asset-price bubbles and diverse wage developments in the euro area but then started to learn after the 2007–2008 global financial crisis and acknowledged their role as lender of last resort for public households under Mario Draghi in 2012, which essentially saved the euro and also demonstrated that the ECB ‘became a highly political central bank’ (Heine/Herr 2021: 118). A crucial limitation of the functioning of monetary policies has been (and is to this day) the lack of a corresponding fiscal authority at European level because central banks can provide liquidity but only fiscal policies can absorb this liquidity if the private sector is not able or willing to do that. Additionally, macroprudential supervision came too late, still does not cover all relevant areas, and is insufficient to address systemic instability in a comprehensive way.

The strength of the book (and this separates it from the publications of the special issue) is that the regime approach allows it to contextualise the ECB’s role and to develop systematically a more functional macroeconomic coordination – at least in principle, given that ‘The European Central Bank’ does not fully exploit the potential of such an approach. Firstly, the focus on monetary policies necessarily downplays other elements of macroeconomic coordination. Fiscal policies are prominently featured, but chapter 11 – which explicitly addresses the lack of a fiscal authority – is especially descriptive and not analytical, which slightly downplays the role of austerity policies although this was surely not intended by the authors. Wage policies, the third pillar of macroeconomic coordination besides monetary and fiscal policies, is mentioned, but its relevance for inflation does not correspond to the space that is devoted to it. Secondly, the regime approach is present throughout the book but only briefly explained in a sub-chapter to the discussion of the first years of the euro area until 2008 (*ibid.*: 80–85). Thirdly, the strength of such a regime-oriented approach is a comparative perspective which is nicely applied to highlight the country-specific developments before the introduction of the euro and until the crisis of 2007–2008. Afterwards, however, such comparisons thin out, and often Germany has to serve as an illustrative example. Obviously, both the German economy and the political influence of the German government is highly relevant for the euro area but more references to other countries would have been useful.

Notwithstanding the above, the concise book – 176 pages plus notes, references and a helpful index – depicts carefully and in a very comprehensible way the institutional basis of the ECB and the developments and challenges of the ECB’s policies over time. It becomes clear that the ECB was influenced by theoretical misconceptions and failed several times to assess the economic situation correctly, but it has to be acknowledged that the underdeveloped institutional setting of the EU and the euro area put the central

bank in a difficult position right from the start. It is both a worthwhile read for students and academics looking for a multi-faceted explanation of monetary policies in Europe since the Bretton Woods system and a focused introduction to the post-Keynesian perspective on monetary policies and its interplay with other policies.

The book was written in early summer 2020. Hence, the latest revision of the ECB's (2021) strategy to adopt a symmetric 2 per cent inflation target in the medium term could not have been taken into account. In their outlook, however, the authors recommend, along with other advice, exactly this to the central bank (Heine/Herr 2021: 169).

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