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The introduction of the Euro: who warned, and why?

Johannes Schmidt¹

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Abstract

This paper analyses the warnings that were expressed before the introduction of the Euro and investigates whether the alerters' conviction that the Euro crisis proved them right is justified. It seems to be the case that the real problems were quite different from the ones discussed before 1999. The paper investigates the question on several levels:

- It analyses the development of the textbook by De Grauwe from the 1st to the current (14th) edition and shows that the problems that were discussed before and during the first years of the monetary union were quite different from the ones that were important in the crisis.
- It looks at some contributions from international economists: Paul Krugman, Barry Eichengreen, and the debate between Charles Wyplosz and Martin Feldstein.
- A special emphasis lies on the contributions of the German Council of Economic Experts ("Sachverständigenrat"): The Council's analyses are a prime example of concentrating on matters that turned out to be of minor importance in the Euro crisis whereas other topics were not touched upon at all.
- Furthermore, it will be shown that before the outbreak of the Euro crisis, some characteristics that turned out to be detrimental for the monetary union were not regarded as a bug, but as a feature. One example is the current account imbalances; another example is the fact of the Euro being like a foreign currency from the perspective of the member states.

Keywords European Monetary Union · Euro crisis · Optimum currency area · European Central Bank

JEL Classification B22 · B27 · E58 · F33 · F45

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1 Introduction

When the Euro crisis broke out, many economists were convinced that the profession had hinted at the problematic aspects of the European Monetary Union (EMU).

But is this conviction really justified? This paper makes the case that the contents of the warnings that were given before and during the first years of the EMU did not have much in common. It will be shown that—although especially heterodox economists issued warnings that touched the relevant points (e.g. Godley 1992)—many mainstream economists' sceptical outlooks did not point to the problems that became virulent during the crisis. They primarily were concerned with inflation due to expansionary monetary policy and/or unsustainable levels of government debts; on the other hand, the problems that really became relevant—diverging competitiveness and differing inflation rates (due to differing increases in unit labour cost), the problem that the Euro is like a foreign currency from the perspective of a member state, the missing lender of last resort function, and the lack of a fiscal capacity on the European level—did not play much of a role. Although it is not possible to consider adequately all contributions, the selected authors are very prominent members of the economics profession, which show exemplarily the stance of the mainstream to the EMU.

The paper is structured as follows: Section 2 treats the question of why many mainstream economists did not see the relevant problems of the construction of the Eurozone. It will be shown that this was due to some specific aspects of the dominant economic paradigm that let the authors focus on problems that were not the core of the crisis. Section 3 analyses the development of De Grauwe's textbook from the 1st to the current (14th) edition and shows that the problems that were discussed before and during the first years of the monetary union were often different from the ones that were important in the crisis. Section 4 looks at contributions from Barry Eichengreen and Paul Krugman and analyses the debate between Charles Wyplosz and Martin Feldstein in the *Journal of Economic Perspectives* in 1997. It will be shown that the points that were prominent in these contributions were not that important in the Euro crisis whereas other problems that were mentioned only as secondary objects at best became central. In section 5, the contributions of the German Council of Economic Experts take centre stage. The Council is one of the main economic advisory boards in Germany and publishes annual reports presenting the economic situation and discussing economic policy proposals. Its analyses are a prime example of concentrating on matters that turned out to be of minor importance in the Euro crisis whereas other topics were not touched upon at all. Section 6 presents some remarkable statements by other economists showing that characteristics that became detrimental for the monetary union were not regarded as a bug, but as a feature: current account imbalances—that were seen as unproblematic or as a positive sign—and the Euro being like a foreign currency from the perspective of the member states. Section 7 concludes.

2 The theoretical underpinnings of mainstream economics

Why did numerous mainstream economists fail to recognise the main problems of the Euro crisis in advance? One major reason for this is probably that the basic theoretical orientation in the mainstream in the wake of the new classical macroeconomics in the 1980s and 1990s led to a clear assignment of tasks to the economic policy actors. Based on the policy ineffectiveness hypothesis (Sargent and Wallace 1975), it follows that expected monetary policy measures have no real economic effects and only influence the inflation rate; only surprises have (short-run) real effects, and money is neutral in the long run. For this reason, and because political actors have an incentive to deviate from an optimal policy path in the short term (Barro and Gordon 1983), it is considered sensible to entrust monetary policy to an independent central bank that does not react to political influences but only aims at price stability. If countries with high inflation join such an arrangement by way of a monetary union, they can follow a path of low inflation (Giavazzi and Pagano 1988).

The real economy is assumed to be stable; Say's law and the long-term dichotomy between the real and monetary spheres apply. Since monetary policy in this setting can ultimately only influence inflation, the level of unemployment is essentially determined by the organisation of the labour market; the NAIRU is determined by supply (Arestis et al. 2001, 115) and can also be influenced by wage policy, among other things: Provided that the inflation rate set by central bank policy is known, the wage partners can also determine the real wage by setting the nominal wage, which in turn determines the level of employment (Hein 2002).

In this setting, fiscal policy essentially has to ensure appropriate framework conditions and is subordinate to monetary policy in its conduct; as excessive budget deficits carry the risk of having an inflationary effect—especially if monetised by the central bank—strict guidelines regarding government debt are required.

Furthermore, financial markets are seen as efficient instruments for the allocation of savings; a developed financial system is seen as an essential building block for economic growth (Levine 1997), while issues of financial stability have taken a back seat. In Europe, too, the political debate prior to the global financial crisis was primarily characterised by efforts to reduce transaction costs (Grahl 2011).

Against this theoretical background, the interactions between the various policy areas and the possibility of a crisis-like development cannot, or only insufficiently, be recognised. Heterodox, especially post-Keynesian analyses differ in several respects: firstly, they see the importance of aggregate demand also in the long run and therefore emphasise the importance of fiscal policy for maintaining sufficient demand for full employment (Arestis et al. 2001, 119). Consequently, it follows that an independent central bank at the European level must be accompanied by a corresponding fiscal capacity in order to compensate for the fact that parity changes are no longer possible (Godley 1992). Secondly, inflation is not

a purely monetary phenomenon, but is essentially determined by the development of unit labour costs, which raises the question of how it can be ensured that member states pursue a wage policy that keeps unit labour costs in line with the central bank's inflation target and prevents a divergence in inflation rates—which can no longer be corrected by changing the parities (Flassbeck 1997). Thirdly, it is emphasised that money is essentially created through the credit creation of the banking system, which has a strongly procyclical character, so that the financial system can be a source of instability (Stockhammer et al. 2020, 237).

The discussions on the question of whether the Eurozone represents an optimal currency area have only been of limited help because the benefits of a monetary union are essentially seen in the reduction of transaction costs, while the connections between political power, fiscal authority, and money creation on the other hand are not discussed (Goodhart 1998). Furthermore, the criteria of the OCA theory, which are supposed to decide whether an optimal currency area exists,¹ often do not lead to a clear result. It is therefore possible that both opponents and supporters of monetary union can refer to the OCA (Snaith 2014). In addition, it has also been argued that after the creation of a monetary union, it would create the necessary conditions for its own success—the synchronicity of business cycles would increase, for example, so that the probability of asymmetric shocks would decrease and thus an essential OCA criterion would become endogenous (Frankel and Rose 1998).

3 Paul De Grauwe's *Economics of Monetary Union*

The first edition of De Grauwe's textbook was published in 1992 and had the title "The Economics of Monetary Integration". With the 4th edition, published in 2000, the title changed to "Economics of Monetary Union"; in 2022, the 14th edition was published.

The structure of the book stayed basically the same: the first part treats the costs and benefits of a monetary union, and the second part treats several aspects of monetary integration (or monetary union).

The interesting part for the topic of this paper is the second part of the book. Here, De Grauwe discusses the problems of incomplete monetary unions, including possible measures to complete them, the transition to the EMU and the convergence criteria, the structure and policy of the ECB, and fiscal policy in the Eurozone.

De Grauwe can be seen as starting from a neoclassical position emphasising clear assignments of tasks but changes his position according to actual developments.

3.1 The problems of an incomplete monetary union

The focus of the chapter(s) about incomplete monetary unions has changed dramatically in the course of the Euro crisis. Up to the 8th edition, published in 2009,

¹ Is the probability of asymmetric shocks low or are there possibilities of reacting to them via geographical labour mobility, flexible labour markets, or the existence of fiscal transfers?

this chapter is mainly concerned with the fragility of fixed exchange rate systems. De Grauwe discusses the credibility problems of fixed exchange rate systems and the speculative attacks that can occur—with the EMS crisis of 1992 as the prime example—and he states that countries can only choose between more flexible exchange rate arrangements or a full monetary union (De Grauwe 2009, 142).

There is, up to the 8th edition, no further discussion of completing the monetary union in terms of the lender-of-last-resort function of the central bank on the market for government bonds or the introduction of common bonds.

That changes drastically with the publication of the 9th edition. Now, the incompleteness of the monetary union refers not only to the abolition of the fixed exchange rate system but—due to the experiences in the Euro crisis—also takes into account that speculative crises can still occur, namely on the market for government bonds. The mechanisms and the possibility of self-fulfilling prophecies and multiple equilibriums are practically the same as in a fixed exchange rate system but that was not foreseen before it actually happened.

3.2 The problem of diverging competitiveness

The problem that the competitive positions of the members of the Eurozone could diverge was not treated until the divergence became clearly visible. This divergence came from persistently diverging inflation rates resulting from different developments of unit labour costs. De Grauwe—and most other authors—did not treat this problem from the start although there have been warnings that a smooth functioning of the European Monetary Union demands an appropriate wage policy (e.g. Flassbeck 1997).

De Grauwe deals with the problem for the first time in the 7th edition, published in 2007. Here, he calls the extent to which the competitive positions of the member countries have diverged as “[o]ne of the surprises of the functioning of that monetary union” (De Grauwe 2007, 32). He mentions that due to the loss of the exchange rate instrument, readjustment might be a painful process which might also induce “a vicious circle ... when everybody attempts to improve its competitiveness at the expense of the others” (De Grauwe 2007, 33). Only with the onset of the Euro crisis, De Grauwe connected it with his analysis of the fragility of incomplete monetary unions regarding crises in the government bond market (De Grauwe 2012, 131).

3.3 Structure and tasks of the ECB

In early editions of the textbook, De Grauwe emphasises that, following the model by Barro and Gordon (1983) concerning time-inconsistent policies, low-inflation countries have not much to gain from joining a monetary union, whereas all the benefits accrue to high-inflation countries. Therefore, provisions are necessary so that the low-inflation country can be sure to get low inflation also in the future. In the wake of the discussion about the Maastricht treaty, De Grauwe

(1992, 160) proposes price stability as the sole objective of monetary policy, opposes high employment as a further policy goal, and advocates for the independence of the central bank in order to prevent the monetisation of government deficits. He is content that the Maastricht treaty contains exactly these proposals.

Two editions later, De Grauwe is somewhat less enthusiastic about these rules: he observed that during the 1990s, growth in the prospective Eurozone countries was quite low, and he conceded that there were “reasons to believe that the Maastricht strategy is at least partially responsible for the lacklustre economic growth observed during the 1990s. The main problem of the Maastricht convergence criteria is that they imposed a policy mix of budgetary and monetary restriction” (De Grauwe 1998, 136).

Apart from the discussion about traditional tasks of monetary policy, the first three editions contain nothing about the tasks of the ECB concerning financial stability and lender-of-last-resort function. These considerations are found only beginning in the 5th edition. Here, De Grauwe indeed predicts correctly that the increasing integration of national banking systems will make necessary central supervisory functions on the European level and the ECB taking responsibility for the lender of last resort function (De Grauwe 2003, 174).

Only in the 9th edition, after the outbreak of the Euro crisis, De Grauwe analyses convincingly the problem that a member country can be forced into default by financial markets and that the central bank should also act as lender of last resort in the government bond market.

3.4 Fiscal policy on European and national levels

Concerning the debate about fiscal policy, De Grauwe treats three issues: the (degree of) centralization of fiscal policy, the argument for fiscal rules, and the problem of fiscal discipline in monetary unions in general.

Indeed, from the very first edition, De Grauwe pleads for the centralization of a substantial part of the budgets of the member states on the European level, e.g. by introducing a European unemployment insurance to dampen asymmetric shocks. If such a centralization is not possible, the traditional OCA theory would advocate flexibility in fiscal policy on the national level (De Grauwe 1992, 165).

But at the same time, De Grauwe treats the problem of potentially unsustainable deficits—unsustainable in the sense that they might lead to ever-rising debt-to-GDP ratios which could either cause inflation (with spillover effects to other countries of the Eurozone) or might make large spending cuts and tax increases necessary. In De Grauwe’s opinion, this makes the case for rules for budget deficits in monetary unions. From the start, he distrusts the argument that private capital markets are able to price the risk of default adequately. The reason for his distrust is that he thinks that capital markets assume an implicit bailout guarantee by other countries, even despite contrary rules like the no-bailout clause in the Maastricht treaty (De Grauwe 1998, 199).

Nevertheless, De Grauwe criticises the SGP from the third edition onwards for being too rigid and not flexible enough.

An interesting discussion in his textbook is the debate about fiscal discipline in a monetary union and the problem of defaults: Does a monetary union give incentives for member countries to increase their deficits or not? A related question is whether the probability of defaults increases or decreases when a country is a member of a monetary union.

For De Grauwe, there are two conflicting processes that are both caused by the fact that in a monetary union, a government can only issue bonds in a “foreign” currency (he was clear about this feature but without seeing the consequence that countries can be forced to default by the financial markets). The incentive for higher deficits comes from the fact that the risk premium could decrease. If a sovereign country issues bonds in its domestic currency, the risk premium consists of two components: the premium for the default risk and the premium for the devaluation risk. As the devaluation risk disappears when joining a monetary union, one is left with the default risk. If capital markets assume an implicit bailout guarantee of other member states, this default risk premium is not very large, leading to large deficits. On the other hand, countries can no longer finance their deficits by money creation; they face a harder budget constraint, which diminishes their incentive for high deficits. (De Grauwe 1998, 200 f.). In later editions, De Grauwe shows that the second effect seems to be more important if one looks at the data since 2000: While the debt-to-GDP ratio increased by 34% in the Eurozone, it more than doubled in the USA and the UK (De Grauwe 2018, 233 f.).

Nevertheless, starting from the 3rd edition, De Grauwe pointed to another problem, referring to a report by McKinnon (1996): the default risk might actually increase in a monetary union: As countries lose control over the central bank and therefore can no longer create a surprise inflation, the probability of default of countries with high debt levels increases (De Grauwe 1998, 203).

Up to the 8th edition, De Grauwe also mentions the counter argument given in a paper by Eichengreen and von Hagen (1995) that default risk in a monetary union is low as long as the member countries maintain control over a large domestic tax base, and therefore, the imposition of tight rules on the member countries has been over-emphasised (De Grauwe 204 f.). But from the 9th edition onwards, this counter argument disappears—due to the experiences with defaults in the Eurozone.

But although the report by McKinnon showed “remarkable foresight of what was to come” (De Grauwe 2018, 237), he still connected the default risk closely with the amount of government debt or the debt-to-GDP ratio, respectively. This might be relevant for Greece, but cannot explain the example of Spain, which until 2012 had a debt-to-GDP ratio lower than Germany’s. Here, on the other hand, De Grauwe was—even before the outbreak of the Euro crisis—correct to connect the size of government bond spreads to the relative competitiveness of countries, measured by the development of their relative unit labour cost (De Grauwe 2009, 242 f.)

4 Selected statements by international economists

4.1 Barry Eichengreen

In the years before the start of the European Monetary Union, Barry Eichengreen analysed several of its problems in about a dozen papers, collected in Eichengreen (1997). The majority of them deal with aspects familiar from the theory of optimum currency areas, which was, as mentioned in section 1, not very relevant. But two papers in the collection are quite relevant for our question at hand: one deals with the EMS crises at the beginning of the 1990s, and the other one treats the necessity (or redundancy) of the stability pact.

In the paper “The Unstable EMS”, Eichengreen and Wyplosz analysed the crises of the European Monetary System at the beginning of the 1990s. Their conclusion is that the crises cannot be fully explained by a recourse to the economic fundamentals, so the first-generation models of currency crises that explained them as a result of unsound fundamentals are insufficient, but the second-generation models are helpful as they show that attacks can happen—even if fundamentals are intact—and be self-fulfilling when the currency peg is no longer defended (Eichengreen 1997, 5).

As a result of their analyses, Eichengreen and Wyplosz forecast (in 1992) further currency crises in case the political/institutional framework does not change. As possible remedies, they discuss more frequent realignments; a faster rush to monetary union, possibly only with a core of countries; more exchange rate flexibility; and throwing sand in the wheels of speculation, e.g. by a kind of Tobin tax. Eichengreen and Wyplosz (1993, 207) see more realignments as problematic given that capital movements are completely unrestricted and that markets tend to anticipate future events. A faster rush to monetary union is seen as improbable as strong-currency countries would not allow it if the other candidates do not fulfill the convergence criteria (which seemed not to be very plausible in 1992/93). Although Eichengreen and Wyplosz think that more exchange rate flexibility is anathema for many actors in Europe, as it threatens to destabilise the common market, that was exactly the measure decided by the members of the EMS (increase in the fluctuation margin to $\pm 15\%$). In contrast, Eichengreen and Wyplosz (1993, 215) at that time favoured the introduction of some kind of Tobin tax to contain excessive speculative movements.

What is interesting in this analysis is the authors’ (albeit implicit) assumption that going for full monetary union would end speculative currency crises. That financial markets could force governments into default was seen as outside the spectrum of imaginable possibilities.

In another paper, Eichengreen and von Hagen (1996) give the answer why they think that the default of one of the prospective member states of the EMU is improbable. The topic of the paper is the fear that countries that borrow unsustainably would be in danger of getting into a debt crisis which in turn might lead to a bailout; the excessive deficit procedure of the Maastricht Treaty was introduced to preclude such a development. But Eichengreen and von Hagen regard this mechanism as superfluous. The reason they give for that lies in the

member states' power to tax. As long as member states control their own tax base, the reaction to a debt crisis does not need to be either bailout or default but an increase in taxes. When member states are able and also expected to do that, the pressure for a bailout can be resisted. Furthermore, "That the cost of coping with the crisis will be borne by the member state itself, in the form of higher taxes, will limit moral hazard" (Eichengreen and von Hagen 1996, 243). Obviously, the speed at which financial markets could enforce the default of governments so that there is—at least in a democracy with its inherently slow decision processes—practically no chance for tax rises was not foreseen by the authors.

4.2 Paul Krugman

Krugman (1993) also argues within the framework of OCA and assumes that the probability of asymmetric shocks will be more important in a monetary union; he thus opposes the considerations of the European Commission, which argues that trade between EU countries is essentially intra-industry trade, characterised by increasing economies of scale and product differentiation, so that countries tend to sell the same products to each other. A sector-specific shock would therefore affect several countries and thus be more symmetrical (European Commission 1990, 142). Krugman's contrary considerations result from his work on economic geography (Krugman 1991): greater economic integration leads to increased specialisation of countries, due to lower trade costs. However, this leads to a stronger regional concentration of industries and thus increases the probability of asymmetric shocks (Krugman 1993, 243ff.). Krugman sees little potential for a national fiscal policy to counteract these shocks—because in his view, such idiosyncratic shocks are permanent, so that ultimately structural changes are necessary and there will be greater labour mobility in Europe. In his view, a national fiscal policy would ultimately not be appropriate due to the permanence of the shocks and would lead to irresponsibly high deficits. The disadvantage of a pro-cyclical fiscal policy, as expressed in the demand for balanced national budgets, would therefore be more than offset by the advantages of "enforced responsibility" (Krugman 1993, 257). If at all, the corresponding fiscal policy to cushion the unavoidable adjustment burdens should take place at European level.

Ironically, in the discussion of Krugman's article, Paul de Grauwe contradicts this and says that national governments can still put the automatic stabilisers to work, as long as they do not allow themselves to be guided too much by the Maastricht criteria (De Grauwe 1993, 269). In the face of the crisis, however, de Grauwe had to change his mind and became a strong advocate of a European fiscal capacity.

4.3 At the cusp of monetary union: Wyplosz vs. Feldstein

In 1997, the *Journal of Economic Perspectives* published two papers: one by Charles Wyplosz and one by Martin Feldstein, who both assessed the pros and cons of

monetary union. Whereas Wyplosz was at least mildly optimistic about the project, Feldstein warned massively against it, calling it an economic liability. Especially, Feldstein shows a neoclassical standpoint that mainly fears inflation.

4.3.1 Charles Wyplosz

For Wyplosz, EMU is indeed a logical step following the previous steps of monetary integration: after the introduction of the Single European Act in 1986, which eventually lifted all restrictions on capital movements and the success (at least in terms of inner-European exchange rate movements compared with fluctuations vis-à-vis the dollar) of the European Monetary System (EMS), the European countries had lost monetary independence—with the exception of Germany (Wyplosz 1997, 5). Germany had a reputation as an inflation fighter, which made it an attractive anchor for the other European countries. Therefore, his final vindication of EMU rests on the problems connected with the situation at the end of the 1980s:

[T]he lifting of capital controls had reduced the alternate options to just two unpalatable extremes: either allow exchange rates to float freely or accept the complete domination of Germany's Bundesbank over Europe's monetary policy. ... On one hand, the Bundesbank derives its leadership from a reputation of undeterred commitment to price stability in Germany. On the other hand, long-lasting leadership requires that all of Europe's economic conditions be taken into account, which is against the Bundesbank's constitutional duty to Germany. Tinkering with the Bundesbank's constitution is not only politically impossible, but doing so would also undermine its credibility and its ability to lead. In this setting, EMU emerges as the best possible economic solution. (Wyplosz 1997, 18)

Wyplosz discusses three points concerning the setup of the monetary union: the OCA criteria, the convergence criteria, and the problems of fiscal policy.

Concerning the OCA criteria, Wyplosz reaches the usual conclusion that the potential member countries do not form an optimum currency area. But he seems to have some sympathy for the idea that these criteria can be endogenous and that at the end of the eighteenth century, the USA might not have been regarded as an optimum currency area—but that does not necessarily lead to the conclusion that they should not have introduced the dollar (Wyplosz 1997, 10).

With regard to the five convergence criteria in the Maastricht Treaty, Wyplosz emphasises that in all issues, the German view has prevailed: it insisted on the strict control of the deficit and debt ratios stated in the Treaty due to fear of inflation.

Moreover, the statutes and objectives of the European Central Bank remarkably resemble those of the Bundesbank: strong independence from government, responsibility clearly limited to price stability, no explicit

involvement in bank supervision, and no lender-of-last-resort function. (Wyplosz 1997, 7)

Especially the last three points became a problem in the first years of the Euro crisis because it increased the insecurity on the capital markets. Wyplosz does not seem—at least at the time of writing—to see these gaps as serious deficiencies of the EMU, but he mentions the possibility that trying to reach the proposed debt and deficit ratios has lengthened the period of insufficient aggregate demand, stagnation, and unemployment in Europe in the 1990s (Wyplosz 1997, 11 f.).

The problem of fiscal discipline is discussed quite intensively in Wyplosz's paper. He concedes that many economists stated that with the loss of the exchange rate as a policy instrument, fiscal policy becomes more important as a stabilising device (Wyplosz 1997, 12), whereas monetary authorities seemed to be more concerned with the danger of having to monetize (part of) government debt. Wyplosz discusses the difficulties of defining the long-term sustainability of government debt and doubts whether the ratios concerning debt/GDP and deficit/GDP in the Maastricht Treaty are reasonable. A limit on deficits of sub-central governments might be sensible if there is a strong central government smoothing out economic fluctuations via transfers between the regions. But as there is no powerful central European government, stabilisation policy on a national level is still needed “and there is no risk that national governments will conduct irresponsible fiscal policies in an attempt to extract transfers from a penniless center” (Wyplosz 1997, 14).

Interestingly, Wyplosz briefly mentions the problem of handing over to capital market the power to control government deficits via interest spreads. In theory, capital markets might price the different risks of borrowers, but he does not think that markets are good at that (Wyplosz 1997, 14). He pointed to the potential problems of governments depending on the volatile assessments of capital markets for their finance, although he did not foresee all aspects of this problem.

4.3.2 Martin Feldstein

In contrast to Wyplosz, Feldstein does not see an economic case for the EMU; he regards it as primarily driven by political considerations whereas a narrow economic assessment leads him to the conclusion that the standard of living will be lower in the medium and long term if EMU is realised (Feldstein 1997, 24). He sees as major political motives that Europe strives for greater unity to pursue a more independent European foreign policy (Feldstein 1997, 25ff.).

Furthermore, there are national interests in EMU but these sometimes are contradictory: France wants greater equality with Germany in terms of economic policy and hopes to end the dominance of the Bundesbank; some German politicians might actually be convinced that EMU will contribute to peace in Europe but many hope that the rules of the Maastricht treaty and the stability pact might bring the

discipline wanted by many Germans and strengthen the dominance of Europe by Germany—expectations that are incompatible (Feldstein 1997, 29).

Feldstein has also a sceptical view concerning the wish of especially smaller countries to have a seat at the table where the relevant policies are discussed and made: he thinks that due to qualified-majority voting and the fact that often only one representative of a group of smaller countries participates in meetings, it will make the influence these countries strive for illusory (Feldstein 1997, 30).

Concerning the economic aspects of EMU, Feldstein considers the positive efficiency effects (reduced transaction costs from using the same currency) as quite small; furthermore, he does not see the net effect from the removal of exchange rate fluctuations as necessarily positive: the disappearance of intra-European fluctuations could be connected with larger fluctuations between the Euro and other currencies, like the US-Dollar or the Japanese Yen (Feldstein 1997, 33f.).

Feldstein predicts an increase of (average) cyclical unemployment if EMU goes ahead (Feldstein 1997, 34ff.). This is due to the fact that a member country of the EMU loses its ability to make monetary policy and that automatic monetary stabilisers (decrease of real interest rate and of the real value of the currency) can no longer work. This is especially problematic as the OCA requirements are not fulfilled.

Concerning inflation, Feldstein thinks that the rate of inflation will go up when the ECB has the sole responsibility for price stability. Although he concedes the strict orientation towards price stability in the Maastricht treaty, he nevertheless emphasises that there is no tradition for independent central banks in Europe. Furthermore, as the members of the governing council of the ECB are appointed by the governments of the member countries, and that the council will decide by simple majority, the anti-inflationary stance of Germany may no longer be sufficient to avoid a—in Feldstein's opinion—too expansionary monetary policy. Additionally, Feldstein thinks that there is no European tradition of supporting the independence of the central bank (Feldstein 1997, 37 f.).

In contrast to Wyplosz, who said that EMU might be the best possible solution due to the contradiction that the Bundesbank sets the monetary policy for Europe without taking into account the economic situation outside Germany, Feldstein defends the situation before EMU, which—in his opinion—has led to an increase of price stability in the 1980s (Feldstein 1997, 40).

Finally, Feldstein sees EMU as a potential cause for an increase in structural unemployment—for him, the bulk of unemployment in Europe at that time. To combat it, one has to introduce reforms that reduce the costs of employment (lower minimum wages, lower payroll taxes, loosening of work rules, etc.) and increase efficiency to increase a nation's competitiveness. Feldstein thinks that this will become more difficult after the start of the EMU as the possibilities of the member states for individual labour-market policies will be reduced (Feldstein 1997, 40).

But the development after the start of the currency union showed that Feldstein's fear did not realise: especially Germany was able to carry out moderate wages

policies to improve its competitiveness as currency appreciations that had often foiled earlier attempts could no longer take place, and no legislation was enacted to prevent Eurozone countries from such policies.

It is equally interesting what Feldstein does *not* discuss: he barely mentions the restrictions for fiscal policy in the stability pact—he supports these restrictions as a way of precluding inflationary developments. Fiscal policy as a tool for stabilisation does not play a role: if there is a need for it, it is only monetary policy. Furthermore, problems of financial stability are not touched upon at all.

5 The German Council of Economic Experts

Since its setup in the beginning of the 1960s, the German Council of Economic Experts² has given many statements regarding the exchange rate system in general and the exchange rate policy in Europe in particular. From its start, the (majority of the) Council supported flexible exchange rates and was sceptical concerning the European attempts to introduce stable exchange rates. For a better understanding of the position of the Council, the following sub-sections report the Council's statements on the European Monetary System (section 5.1), on the policy after the adoption of the Maastricht Treaty (section 5.2), on the developments of the first years of the European Monetary Union (section 5.3), and the proposals for dealing with the crisis (section 5.4). In general, the Council's statements are a prime example of adherence to the neoclassical paradigm: stability assumption for the private sector, clear assignments of political tasks, inflation as a monetary phenomenon, and strict avoidance of government deficits.

5.1 The European Monetary System

In its first assessment of the plans for the European Monetary System (EMS), the Council remains sceptical. On the one hand, fixed exchange rates might increase the national autonomy concerning employment policy: restrained wages and cost-dampening supply-side policies would no longer be hampered by flexible exchange rates; an improvement of a country's competitiveness could now only be compensated by an equivalent slowing of foreign increases of costs and prices. The possibility of

² "The German Council of Economic Experts is an academic body that advises on economic policy issues. Set up by law in 1963, it is mandated with the task of providing an impartial expert view in the form of periodic assessments of macroeconomic developments in Germany, thus helping economic policymakers and the general public to make informed decisions. The Council is fully independent in its advisory role and operates in a transparent manner. It describes the current economic situation and its likely future development, highlighting any adverse trends and possible ways of averting or mitigating them. To this end it discusses various indicators of economic output, quality of life, sustainability, and politically defined targets. It also analyses the progress, opportunities and risks of current economic policies and identifies potentially conflicting objectives. The Council's reports and assessments form a key part of the economic policy debate in Germany and have significantly influenced the political decision-making process". This information is taken from the Council's website: <https://www.sachverstaendigenrat-wirtschaft.de/en/about-us/objectives.html>.

reaching a competitive advantage not only on the level of firms or sectors but also in the whole sphere of foreign trade could lead, according to the Council, to a stimulation of the international competition for stability and growth (annual report 1978/79, 154f.)—which is regarded as unambiguously positive by the Council. On the other hand, the Council distrusts the rules for mutual assistance and obligatory interventions on the foreign exchange market: they might lead to too expansive increases of the money supply, especially in the countries under revaluation pressure and, in the end, an alignment of inflation rates on a medium level instead of the lowest one (annual report 1978/79, 155). All in all, the Council thinks that the hope for a harmonisation of monetary policies is—at the beginning of the EMS—unfounded; the initial situation is rather worse than at the beginning of the 1970s, mainly due to higher inflationary differences (annual report 1978/79, 159f.).³

Whereas in 1982 the Council still criticised the differences in inflation rates as a source of necessary realignments (annual report 1982/83, 31), there were practically no negative comments in the following reports, and the Council had to concede in 1986 that the EMS was quite successful—but more or less only due to the anchoring function of the German Mark.

When the discussion about introducing a common European currency gained momentum, the Council warned against a quick fixation of exchange rates (annual report 1988/89, 166). It would be much more important to reach a convergence of monetary policy (subject to price stability); here, the Council emphasises the importance of an independent monetary policy. Apart from that, the Council pleads for a convergence of fiscal policy in the member states: it sees the willingness to give up sovereignty in the field of public finances as a test case for the willingness to go for a political union. The Council does, at this stage, state nothing concerning fiscal policy on the European level, but in any case, it does not seem to see a role for national fiscal policies; furthermore, the differences concerning budget deficits and debts are seen as major burdens: as inflating away the debt is excluded in a monetary union, that could mean transfers from countries with lower debts and deficits—a perspective the Council disapproves of as long as the political union is not established. The completion of the internal market is seen as one important step in the direction of political union, but for this, spectacular decisions concerning currency policy are not demanded. Instead of that, a complete and irrevocable liberalisation of capital movements as well as a more intensive coordination of the monetary and fiscal policies of the member states should be strived for—always subject to the primacy of stability.

In 1989, after the publication of the Delors report, the Council warns against precipitate steps, especially concerning the fixation of parities: during the transition process, the instrument of realignments is still needed. For the Council, the function of the German Mark and the Bundesbank as anchors for stability is still essential; it pleads for the independence of all other European Central Banks and a “stability competition” between them—only that could make the German anchor dispensable (annual report 1989/90, 183).

³ This assessment is repeated 1 year later (annual report 1979/80, 137).

Additionally, the Council starts to focus on the role of budget deficits and debt. Both are, according to the Council, important for the solvency risk of a country: it increases with rising deficits and increasing debt, if interest payments make up already a large part of the budget (annual report 1989/90, 184). As the EMS will try to introduce realignments more and more infrequently the pressure for a convergence of inflation rates will increase. But that, in turn, bears the danger that the level of inflation in Europe will increase as some member states still have high budget deficits and let them finance by loans from the central bank. Therefore, the Council demands a prohibition of (direct) monetisation of budget deficits and also rules for the budget policy of the member states of the EMS and the prospective members of the monetary union: these rules should be easy to handle, they should include percentage shares of public investment or of GDP as limits for public deficits, and there should also be limits on the stock of government debt as a share of GDP (annual report 1989/90, 186).

In later reports, the strict orientation on price stability gets more intensified. In 1990, the Council supports the aim for an extensive monetary and real convergence of the European states before introducing irrevocably fixed exchange rates or a common currency; furthermore, the internal market has to be finalised including freedom of capital movement; the completion of these requirements has a strict priority over reaching deadlines (annual report 1990/91, 223f.). The German Bundesbank and its structure are, in principle, seen as a role model for the prospective European Central Bank; the most important requirement is its independence. The Council rejects all proposals for wider-ranging coordination of macroeconomic policies as that would lead to guidelines for the central bank and, finally, weaken or even abolish its independence. Even the proposal for a “support of general economic policy” is seen as problematic (although a similar assignment could be found in the German Bundesbank law) as the tradition of stability in Europe is not as pronounced as in Germany. In the same report, the Council emphasises again the need for fiscal rules (annual report 1990/91, 226).

Transfer payments within the prospective monetary union are declined: the benefit from joining a monetary union is the advantage of a common and stable currency; there are no disadvantages that would justify financial compensations. Of course, according to the Council, the abandonment of the exchange rate mechanism requires flexibility of other economic variables, e.g. wages. But if this flexibility cannot be achieved, the country should not join the monetary union (annual report 1990/91, 227).⁴

5.2 After maastricht

As the German Bundesbank increased interest rates after German unification, a conflict broke out between the (perceived) domestic need for higher interest rates and its effect on other European countries. But the Council thinks that the Bundesbank

⁴ These considerations show up again 1 year later (annual report 1991/92, 213 ff.)

must not weaken its restrictive course only because of the external effects; rather, the domestic inflationary forces have to be pushed back so that there would no longer be a reason for a restrictive course (annual report 1992/93, 200). In the same report, the Council—albeit reluctantly—lauds the stability criteria in the Maastricht Treaty; especially, it praises the result that quantitative factors objectify the assessment of whether the policy of the member states is consistent with stability requirements. On the other hand, the convergence concerning real variables (development and productivity) cannot be derived from these nominal criteria, but that is important as a monetary union of countries with different levels of development would increase the pressure for expansive monetary policy and financial transfers—two things the Council strongly declines (annual report 1992/93, 237).

Against the background of the crisis in the European Monetary System and the enlargement of the fluctuation margin ($\pm 15\%$) in 1993, the (majority of the) Council makes now an interesting turn: since its setup, the Council was a defender of flexible exchange rates and only a reluctant supporter of the system of fixed but adjustable rates in Europe; now, it pleaded for the accomplishment of the European Monetary Union. The reason is that the Council fears a re-nationalisation of economic policy when countries have a degree of freedom concerning the exchange rate which might lead to competitive devaluations; that would endanger the steps of European integration accomplished so far. The Council sees that the free movement of capital might lead to expectations of exchange rate changes that are not connected to economic fundamentals. But the conclusion is not that capital movements should be re-regulated or restricted; rather, the potentially destabilising effects of unrestricted capital movements and the speculative attacks that are connected with them can be controlled only by a radical step: the transition to the European Monetary Union (annual report 1993/94, 233). The interesting turn is that, in earlier reports, the Council regarded free capital movements as a necessary condition for forming a monetary union; now, the monetary union is the necessary answer to get the speculative capital movements under control.

In the reports of the years before the start of the monetary union, the Council mainly emphasises the necessity of a strict application of the criteria for joining the monetary union, especially the inflation and deficit criteria, without margins of discretion (annual report 1995/96, 246ff.; 1996/97, 214ff.) and sanctions that should be applied more or less automatically should the criteria be breached; the sanctions should be equal to an interference with the sovereign rights of a country (annual report 1995/96, 255; 1996/97, 157).

On the cusp of monetary union, the Council again emphasised stability orientation as the *conditio sine qua non* of European monetary policy and recommends a monetary targeting; the—at that time—quite new policy of inflation targeting is met with scepticism (annual report 1997/98, 221ff.). One year later, the Council again recommends an objectivation of the money supply and pleads for adherence to rules, preferably monetary rules (under the assumption that the money demand function is stable); furthermore, the Council still emphasises the necessity of consolidation of public budgets (annual report 1998/99, 179ff.).

In the same report, the Council deals with apprehensions that there is a deflationary danger in the Eurozone due to a possible downward spiral of wages. The Council

declines this and states that such fears are misplaced and that the idea of a downward spiral is fanciful (annual report 1998/99, p.178). It concedes that jobs within the monetary union compete more intensively due to higher transparency of prices and costs but that there is no danger of a downward spiral: a restrained wage policy just means wage increases below the productivity increase to create more jobs; if that is accomplished and the unemployment has gone down, then the competition for workers will make sure that wages rise according to productivity again. Furthermore, changes in the real exchange rates within a monetary union will take place: when a country has got into a crisis, this real depreciation (via restrained wage increases or even wage reductions) will bring a new macroeconomic equilibrium; when that is reached, there will be no need for further changes, and therefore, there will be no downward spiral (annual report 1998/99, 196f.). One can see here that the (majority of the) Council locates the reason for unemployment nearly exclusively in wage policy.

5.3 The first years of the monetary union

After the start of the monetary union, the Council mainly discusses the monetary policy strategy of the European Central Bank, emphasising the necessity of a credible course, again demanding a clear monetary target and declining a role for the ECB in business cycle policy (annual report 1999/2000, 148f.). Furthermore, fiscal policy is a recurring theme in these years, emphasising the importance of the consolidation of public budgets. In this context, the Council discusses intensively the importance of non-Keynesian effects of discretionary policy, which again is an argument for consolidation (annual report 2003/04, 443ff.). Insisting on a strict adherence to the stability pact is a kind of *ceterum censeo* in the Council's reports in this decade. Even in 2009, during the financial crisis and on the cusp of the Euro crisis, the Council still pleads for the consolidation of public budgets and regards balanced budgets as a longer-term goal (annual report 2009/10, 82ff.).

In several reports, the Council discusses problems that came up in the first years of the monetary union, but it did not draw the conclusions that would have been necessary concerning the development of the Euro crisis:

- Persistent inflation differentials
 - o Already in 1999, the differing development of the price levels in several Euro countries is mentioned. That phenomenon and its persistence are discussed again in 2001. Insofar as these differing inflation rates are caused by differing positions of the countries in the business cycle, the Council sees them as positive, as they are automatic stabilisers; the persistence is regarded as a potentially greater problem, but the Council does—at least in 2001—neither connect it to current account imbalances nor to wage policy (annual report 2001/02, 267ff.).
 - o In 2005, the Council treated the problem once more and listed several reasons for differing inflation rates. Besides other points, the differing developments

of unit labour costs were mentioned, and the Council even stated that unit labour costs were more important than other points. However, the Council did not criticise that unit labour costs in Germany increased insufficiently, but it only mentions that Ireland, Portugal, Spain, and Italy had deteriorations of the cost competitiveness and had also inflation rates above the Euro zone average (annual report 2005/06, 422).

- Current account imbalances
 - o Interestingly, the Council states as one of the positive effects of the common currency that all benefits of a restrained wage policy are no longer nullified by appreciations (annual report 2005/06, 408f.). That can be interpreted as a calling for further wage restraint and indeed, even in 2009, the Council recommends that the bargaining partners should continue with the non-exhaustion of the margin of distribution (annual report 2009/10, 280).⁵
 - o Also in 2005, the Council discusses the problems resulting from differing inflation rates in terms of competitiveness. But a higher inflation rate in a member country means a real appreciation, and this is regarded—at least in the long term—as an effective adjustment mechanism that precludes a destabilisation of the currency union due to differing inflation rates (annual report 2005/06, 420ff.). Five years before the crises, the Council is quite optimistic about the self-regulation of current account deficits; there is no need to undertake specific measures. The degree to which current account deficits that are unsustainable in the long run can be financed within a currency union is underestimated by far.

5.4 The Council during the crisis

With the outbreak of the Euro crisis, the Council suddenly discusses all the points that have come up as important causes of the Euro crisis:

- The current account imbalances and the large financial balances in the private sector that caused them (annual report 2010/11, 71ff.)
- The problem of “original sin” so that the Euro is a foreign currency when looked at from the perspective of a single member country (annual report 2010/11, 81ff., annual report 2011/12, 93ff.)

But interestingly, the reform proposals that the Council derives from this analysis are still not very different from its former stance. So the Council still sees consolidation of public budgets as important; it does not think that more expansive fiscal policy or larger wage increases, especially by Germany, could play a role in bringing

⁵ Only one member, Peter Bofinger, rejects this recommendation in a minority vote (annual report 2009/10, 299 ff.)

down the imbalances (annual report 2010/11, 111ff.); it still emphasises the inter-temporal approach when looking at the balance of payments and does not see large current account deficits as necessarily problematic as they can be a sign of a country being a very attractive investment location with a high growth potential (annual report 2010/11, 107), and it still favoured a stronger stability pact whereas it rejects the introduction of a common fiscal capacity and of common bonds due to the risk of moral hazard (annual report 2017/18, 55).

6 Characteristics of the EMU: features or bugs?

6.1 Current account imbalances

With the start of the Euro, the current accounts of the member states of the EMU started to show growing surpluses and deficits. With hindsight, we know that these current account imbalances were one of the problems causing the Euro crisis as countries with current account deficits (that translated into growing negative net international investment positions) were the victims of speculative attacks or sudden stops concerning capital flows: on the government bond market, current yields increased sharply as financial investors sold off bonds. The cause for that was not (maybe except the case of Greece) unsustainable public debt but large private debt that led to large current account deficits; the government bond market served as a kind of a valve where the financial investors' panic showed up.

But the interesting thing is that these current account deficits were not seen as a major problem when they started to come up. Here, the optimism about the efficiency of financial markets, mentioned in section 1, comes into play. One example for that is a paper by Blanchard and Giavazzi (2002) about current account deficits in the Euro area. In this paper, they focus on the current account deficits of Portugal and Greece and try to find an explanation for them. Their basic message is that there is no need to worry and that benign neglect might be the best answer to it. Portugal's and Greece's current account deficits

“are exactly what theory suggests can and should happen when countries become more closely linked in goods and financial markets. To the extent that they are the countries with higher expected rates of return, poor countries should see an increase in investment. And to the extent that they are the countries with better growth prospects, they should also see a decrease in saving. Thus, on both counts, poorer countries should run larger current account deficits, and, symmetrically, richer countries should run larger current account surpluses.” (Blanchard and Giavazzi 2002, 148)

Blanchard and Giavazzi build a model for explaining the deficits and attribute them to European integration. This integration process has, according to the authors, led to three effects that resulted in less saving and more investment in these countries and therefore higher current account deficits (Blanchard and Giavazzi 2002, 153f.): First, the goods market integration (the single European market) led to an increase of the elasticity of demand for each good: harmonisation of safety requirements and

the more extensive distribution networks made goods closer substitutes for each other. Second, financial integration has reduced the rate at which prospective debtors can borrow; due to the harmonisation of financial market rules, the regulatory uncertainty foreign lenders face has been reduced and the transparency of information on potential borrowers has been increased, reducing risk premia. Third, monetary union has eliminated the currency risk which further reduced the risk premium lenders demand; in addition, it has led to deeper and larger capital markets. These developments make borrowing more attractive but could also lead to more investment. And as poor countries have less capital, the marginal product of capital will be higher, which also makes investment more attractive.

Blanchard and Giavazzi state that this increased integration leads to a decrease in the correlation between national saving and national investment, thus dissolving the decades-old Feldstein-Horioka puzzle of high correlations between these two variables; savers can look for the best way of allocating their savings and are no longer confined to the national capital market. Therefore, there is no need to actively intervene in this process (Blanchard and Giavazzi 2002, 183 ff.)

With hindsight, one can say that the whole idea that current account deficits are beneficial for poor (or developing) countries did not fulfill its promises. Historical experience tells us that all successful processes of catch-up and development were closely connected with current account surpluses—China only being the latest example of that. Rightly, the European Union now takes a closer look at current account imbalances; the benign neglect only led to problems that emerged abruptly in the Euro crisis but were not seen before. One reason for that was that only public debt was seen as a potential problem.

6.2 A money you cannot make by yourself

One of the problems that became visible during the Euro crisis was that from the perspective of a single member country of the EMU, the Euro is a foreign currency as it cannot be created by the national central bank which, as a result, cannot act as a lender of last resort on the government bond market. This was the central difference to countries with their own central bank like Great Britain or the USA who were not hit by a crisis in the government bond market.

However, exactly this problem of the monetary union was seen—at least by some economists—as one of the main features of the monetary union. One example is Olaf Sievert, himself a former member of the Council of Economic Experts. His main argument in favour of the European Monetary Union (Sievert 1993) is indeed that the prospective member states of the European Monetary Union want to introduce a money that they cannot make by themselves. And this decision is seen as beneficial in nearly every aspect. On the other hand, the history of monetary relations is, according to Sievert, a history of the improper use of the right to create money: leading to inflation and to voiding debt one had promised to pay back with sound money. Sievert lauds the gold standard period which precluded all these abuses, and he thinks that the monetary union comes close to this “golden” period of monetary history (Sievert 1993, 14). He takes this argument one step further by

saying that also the incompleteness of the monetary union is in fact also a benefit, and he would regard it as a mistake to go for a full political union as a unitary state or a federal state is much closer to the central bank than the members of a federation of states (Sievert 1993, 15).

In his paper, Sievert makes other claims concerning the benefits resulting from a monetary union: the labour markets in the union will become truly competitive markets, and as the responsibility for price stability is clearly assigned to the European Central Bank, then wage policy must accept its responsibility for employment: nominal wages are also real wages as the monetary conditions that determine inflation are no longer changed according to the wage policy in the member countries (Sievert 1993, 17). And as changes in the exchange rate are no longer possible and unions cannot hope that the central bank will act inflationary that will act as an effective barrier against false wage policies.

The astonishing thing is that Sievert obviously sees no necessity for any safeguards as, for example, a lender of last resort. Here, again, the optimism concerning the efficiency of financial markets plays a dominant role. For him, it seems to be obvious that crises are the result of unsustainable and irresponsible behaviour by governments and that the incentives for such irresponsible behaviour can be removed by introducing a money you cannot make by yourself. Similarly, one is puzzled about his unrestricted support for the gold standard when, at about the same time, Eichengreen (1992) showed that the adherence to the gold standard intensified the depression in the 1930s.

7 Conclusion

This excursion in the literature before the start of the European Union showed that indeed the actual problems that came up in the Euro crisis—current account imbalances due to unsustainable financing decisions of private agents (instead of the government) and due to diverging competitive positions of the member countries; the problem of government defaults forced by financial markets due to a missing lender-of-last-resort function of the central bank; and the lack of a fiscal capacity on the European level—were often not or only barely mentioned in the literature.

The paper has shown that many discussions about the European Monetary Union before its start focussed on the one hand on problems that did not become very important during the crisis. Even Paul de Grauwe, who brilliantly analysed the problem that the Euro has become a foreign currency for each member state, did so only after the crisis began. But he changed his analysis after the facts changed. On the other hand, there were protagonists that stuck to their guns even with hindsight. For example, the German Council of Economic Experts focussed on the possible dangers for price stability when Germany loses its role as stability anchor within the European Monetary System. It insisted on the strict application of the convergence criteria and was practically blind to the problems that really came up during the crisis. And even after the crisis broke out and the Council's analyses made some important points, it still shows a nearly stubborn adherence to questions of sound

public finances and consolidation without admitting the necessity of a lender of last resort (on the government bond market) or a fiscal capacity on the European level.

On the other hand, one can find analyses before (and shortly after) the start of the EMU that emphasise supposed features and benefits of the monetary union that turned out to be its greatest faults: the formation of current account imbalances and the fact that the Euro is a foreign currency from the perspective of a single member state.

In summary, one could state: the alerters were afraid of a monetary union that threatened to undermine the alleged conditions for general prosperity: free markets, sound money, and balanced public budgets. Nearly all of the warnings either mentioned the seemingly serious—for some commentators: the central and overarching—problem of increasing inflation, the pitfalls of overly excessive fiscal policy, or the danger of a central bank giving in to (unwarranted) demands for expansive monetary policy. One is puzzled by the authors' confidence that market processes will lead to a beneficial outcome and that there is no necessity to make provisions for the possibility of a major crisis. If you strive for stability, everything else will fall into place.

Of course, it might seem smart-alec to criticise with hindsight that economic experts did not point to the real problems of the Euro zone, but the fact that at least some economists—often rather heterodox ones—pointed to real problems (e.g. Godley 1992) should lead to questions whether the perspective was really adequate. At the very least, the failure of tackling the real problems in advance should lead to an intellectual modesty.

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