



lavoce.info

Bocconi University

Milano, June 5th, 2017

|| Ideas versus/and Interests

- **Ideas** - ideologies matter!
 - Different economic philosophies
- **Interests**/incentives are interpreted through the lens of ideas



Aim of the book:

- Make differences clear to policy makers
- First step to overcome them

||| Euro crisis “Watershed Moments”

- 2010, May: EFSF, IMF involvement
 - 2010, Oct: Deauville PSI: contagion
- } Powershift
- 2012: Draghi’s “Whatever it takes” Speech
 - 2013: Cyprus Bail-in
 - 2016: Brexit

|| Rhine-Divide in Economic Philosophies

Ideal types (Max Weber) White-black comparison to sharpen contrast

“French”



“German”



“Rhine-divide”

|| Rhine-Divide in Economic Philosophies

“French”

1. Discretion



“German”

Rules



|| Rhine-Divide in Economic Philosophies

“French”



1. Discretion
Straitjacket commitment

“German”



Rules
Safety/escape valves

|| Rhine-Divide in Economic Philosophies

“French”



1. Discretion
Straitjacket commitment
- No debt restructuring mech.

“German”



- Rules
Safety/escape valves
- PSI (Greece)



Deauville,
Oct. 2010

|| Rhine-Divide in Economic Philosophies

“French”



1. Discretion
Straitjacket commitment

- No debt restructuring mech.
 - Banks as hostage

“German”



Rules
Safety/escape valves

- PSI (Greece)
 - Banks as insurance providers

|| Rhine-Divide in Economic Philosophies

“French”



1. Discretion Straitjacket commitment

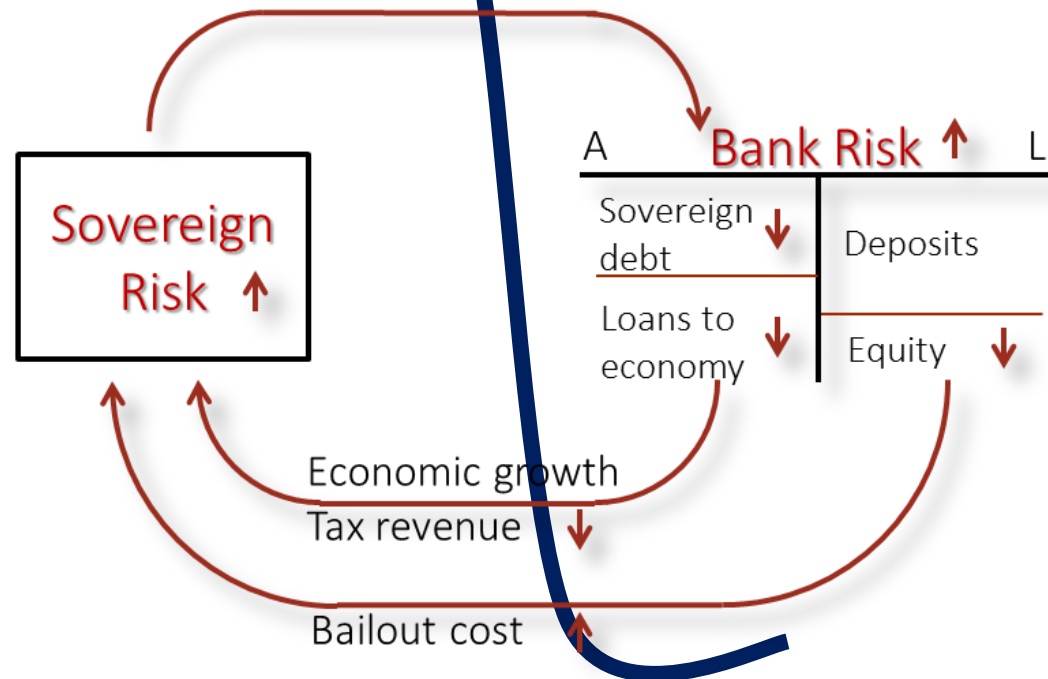
- No debt restructuring mech.
 - Banks as hostage

“German”



Rules Safety/escape valves

- PSI (Greece)
 - Banks as insurance providers



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“French”



1. Discretion Straitjacket commitment

- No debt restructuring mech.
 - Banks as hostage
- No EMU exit rules
Currency peg

“German”



Rules Safety/escape valves

- PSI (Greece)
 - Banks as insurance providers
- Flexible exchange rate

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1. Discretion Straitjacket commitment

- No debt restructuring mech.
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Rules Safety/escape valves

- PSI (Greece)
 - Banks as insurance providers
- Flexible exchange rate

Autonomous
Monetary Policy

Fixed ex-
change rate

Free
capital flow



|| Rhine-Divide in Economic Philosophies

“French”



1. Discretion
Straitjacket commitment

2. Solidarity

- Fiscal union
- Eurobond

“German”



Rules
Safety/escape valves

Liability

- no transfer union, no-bailout
- no joint liability!

|| Rhine-Divide in Economic Philosophies

“French”



1. Discretion
Straitjacket commitment

2. Solidarity

3. Liquidity

“German”



Rules
Safety/escape valves

Liability

Solvency

$E[NPV] > 0$, at what discount rate?

“throw good money after bad”

|| Rhine-Divide in Economic Philosophies

“French”



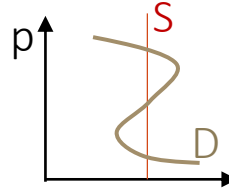
1. Discretion
Straitjacket commitment

2. Solidarity

3. Liquidity

- multiple equilibria
“big bazooka”

Draghi speech,
Summer 2012
€ 0 spent on OMT



“German”



Rules
Safety/escape valves

Liability

Solvency

$E[NPV] > 0$, at what discount rate?
“throw good money after bad”

Rhine-Divide in Economic Philosophies

“French”



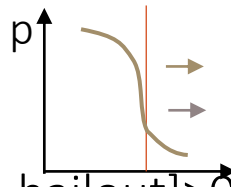
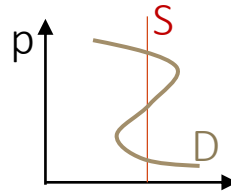
1. Discretion
Straitjacket commitment

2. Solidarity

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- multiple equilibria
“big bazooka”

- amplification/spirals
 - $E[\text{NPV bailout}] > 0$
 - $E[\text{PV bailout} - \text{PV no bailout}] > 0$



↑
contagion/systemic

“German”



Rules
Safety/escape valves

Liability

Solvency

$E[\text{NPV}] > 0$, at what discount rate?
“throw good money after bad”

Cyprus,
Spring 2013
Bail-in become norm
for banks

|| Rhine-Divide in Economic Philosophies

“French”



1. Discretion
Straitjacket commitment

2. Solidarity

3. Liquidity

4. Keynesian Stimulus

“German”



Rules
Safety/escape valves

Liability

Solvency

Austerity/Reform

|| Rhine-Divide in Economic Philosophies

“French”



1. Discretion
Straitjacket commitment

“German”



Rules
Safety/escape valves

2. Solidarity

Liability

3. Liquidity

Solvency

4. Keynesian Stimulus

Austerity/Reform



switched sides after WWII
Differences are not caste in stone!

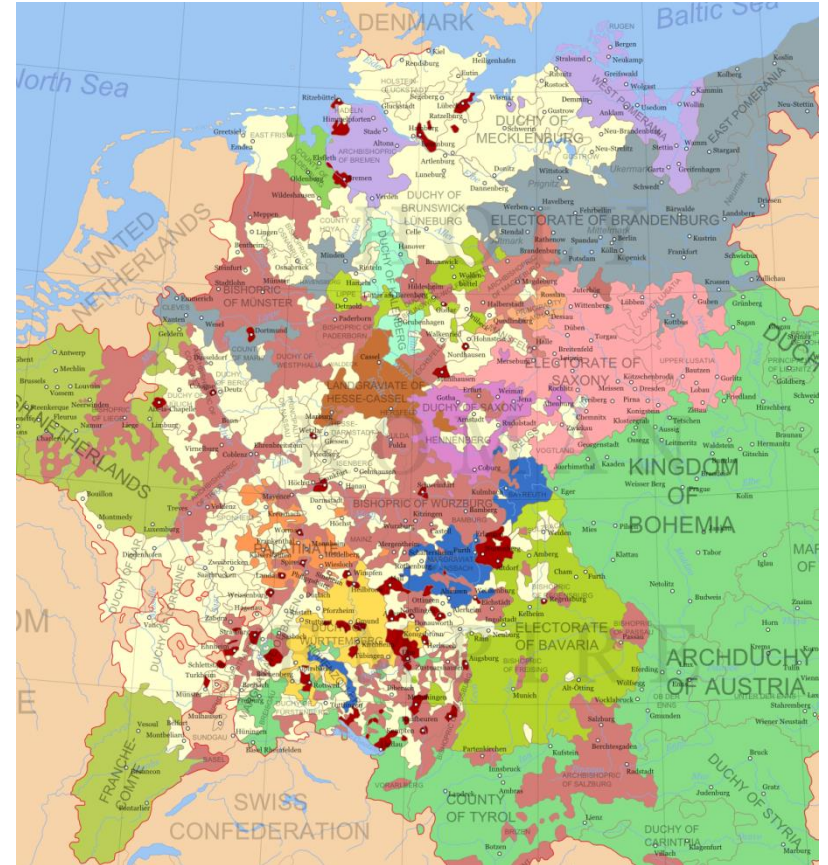
Is difference cast in stone? ... cultural?

■ “French” Absolutism/Centralism



- King Louis XIV, XV, XVI
 - 1643-1715, 1715-1774, 1774-1792 A.D.

■ “German” Federalism



- Holy Roman Empire

|| ... or fickle?

“France”

“Germany”

- Early 18th century
Dirigisme/grand design

- 18/19th century
from **laissez-faire**

- After WW II
to **planisme**

from **cameralism**/state tradition

Reversal

to **Ordo-liberalism**



Italy

■ Economic Philosophy

- Piero Sraffa (Cambridge)
- Franco Modigliani (MIT)

Luigi Einaudi (Banca d'Italia)

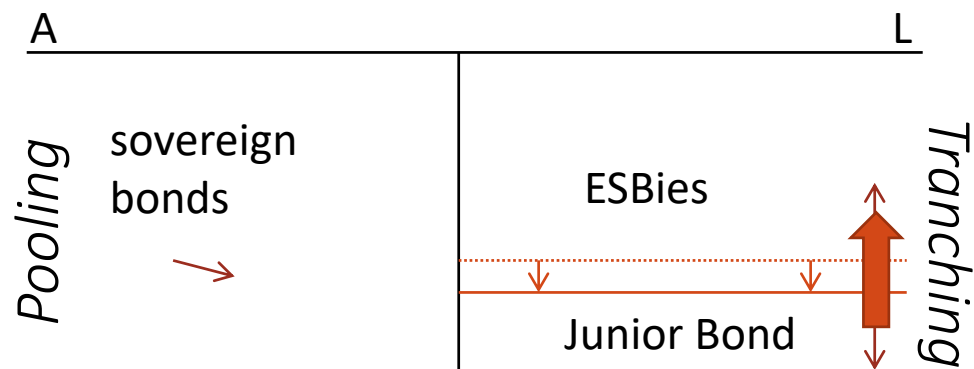


■ Italian “Mezzogiorno-transfer union” (North & South)

- Convergence until 1960s
- Divergence after 1970s

ESBies/SBBS: Safe Asset

Sovereign Bonds Backed Securities



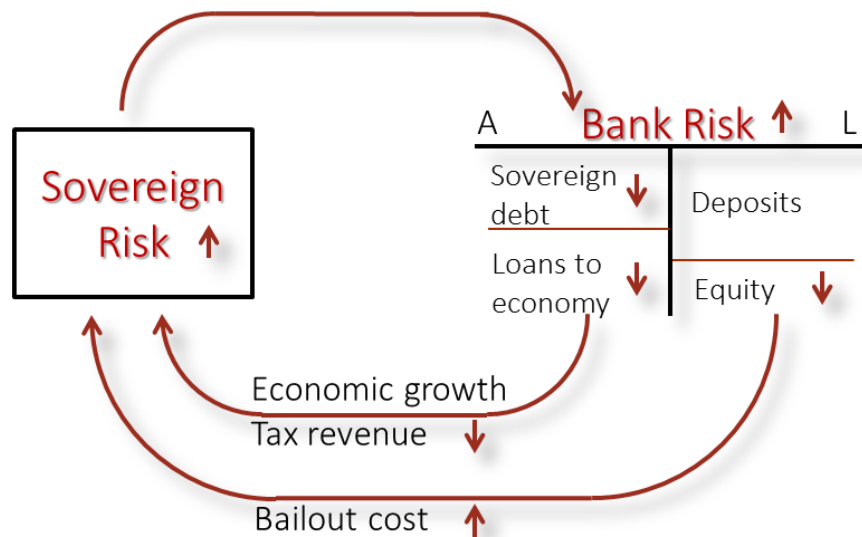
No Joint liability
No Eurobond!

- Euro-nomics Group (2011)

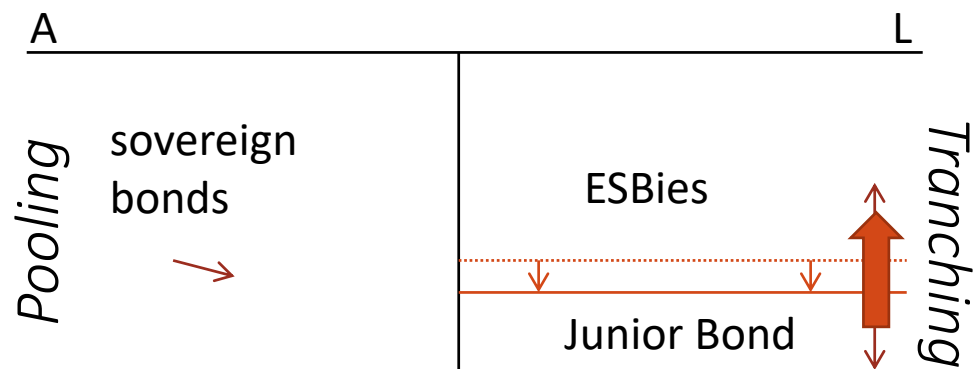
ESBies/SBBS: Safe Asset

■ Diabolic loop

- Sovereign-Banking Nexus



- Eliminated



No Joint liability
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ESBies/SBS: Safe Asset

■ Diabolic loop

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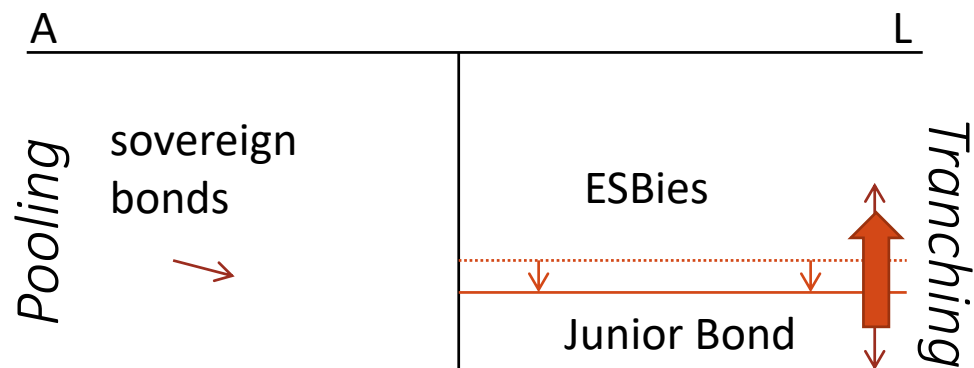
■ Flight to safety

- Cross-border



- Eliminated

- Re-channeled across two European bonds



No Joint liability
No Eurobond!

- Euro-nomics Group (2011)

Conclusion

- Ideas matter! – not only interest/incentives
- Powershift in 2010
 - IMF, EFSF → Intergovernmental
 - Deauville → Paris-Berlin
- “Rhine Divide” – switching sides after WWII
 - Price and fiscal stability
 - Financial stability
- ECB’s philosophy and recap of banks vs. IMF perspective
- Proposals
 - European Safe Bond (ESBies)
 - Fire-walls & “Race away from the bottom”, ...

