Jens Weidmann: Exploring the agora - lessons for a more stable economic and monetary union

Speech by Dr Jens Weidmann, President of the Deutsche Bundesbank and Chairman of the Board of Directors of the Bank for International Settlements, to the Hellenic Bank Association, Athens, 30 August 2018.

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1 Introduction

Mr Karamouzis,
Deputy Prime Minister,
Governor Stournaras,
Representatives of the Greek political parties, the Greek banks and the Greek economy,
Ladies and gentlemen

Καλησπέρα! – Good evening!

It's a great pleasure for me to be here today, in this beautiful country, in this vibrant city, in this prestigious hotel on Syntagma Square at the heart of modern Greece. Thank you for your invitation and your kind hospitality.

Allow me to start by saying that I was shocked by the TV images of deadly wildfires ravaging the coastal areas of Attica, a few weeks ago. My thoughts were with the victims, my condolences and sympathies go to their families and the entire Greek people.

Greece is often said to be the cradle of Western civilisation, and rightly so. One could say that the Greeks invented the way we think. Or, in the words of the English poet Percy Shelley: "We are all Greeks. Our laws, our literature, our religion, our arts have their root in Greece."[1] The lasting impact becomes obvious when one considers the many words of Greek origin in our modern-day languages: words like "policy", "democracy", "economy", but also "idea", "theory" and "dialogue".

Austrian thinker Karl Popper observed once – and I quote: "The war of ideas is a Greek invention. It is one of the most important inventions ever made. Indeed, the possibility of fighting with words and ideas instead of fighting with swords is the very basis of our civilization, and especially of all its legal and parliamentary institutions."[2]

How could this kind of discourse have been invented? A key step may have been that ancient Greeks created a public meeting place in the very heart of the city-state: the "agora". Here, citizens exchanged views, discussed politics and celebrated cultural events. The best-known example of an ancient agora is situated not far from here.

Just a few years ago, Joachim Gauck, then Federal President of Germany, said in a speech that Europe would need an agora in order to develop a common European civic spirit.[3] So this idea of a forum for public discourse is still with us today. And, indeed, a culture of open debate and a lively democracy are hallmarks of present-day Greece.

Yet the ancient agora not only allowed an exchange of views, but, more tangibly, also defined the marketplace of a city (as it still does in modern Greece). Here, merchants and craftsmen sold their products. In this respect, it set an essential foundation for prosperity.

The link between the economic and political spheres also provides the blueprint for my speech this evening. In particular, I am looking forward to sharing some thoughts on the Greek economy and my view on European integration with this distinguished audience.

2 Greece

2.1 Economic conditions

Ladies and gentlemen

Ten days ago, Greece successfully concluded the third adjustment programme. After more than eight years, Greece is now ready to stand on its own feet again. This is really good news!

The Greek people have made a great deal of progress on the path towards fiscal and economic sustainability. Before the crisis, Greece had an enormous twin deficit. In 2008, the current account deficit stood at 15% of GDP, while the state's budget deficit also peaked at 15% in 2009. Last year, by contrast, the government ran a surplus of 0.8% of GDP, and the current account was virtually balanced.

This impressive progress has resulted from comprehensive budget consolidation measures and economic reforms that were implemented over the past years. It is true: these changes did inflict severe social and economic hardships on the Greek people. Acknowledging the sacrifices, I have great respect for the Greek people and the way in which you all endured this difficult period.

In the course of an arduous adjustment process, the Greek economy slid into a deep recession: output dropped by more than a quarter overall. Now, a recovery has finally set in. Improved competitiveness due to labour market reforms and lower unit labour costs combined with rising external demand is boosting the export of goods. Tourism is also booming. The Greek economy has become more open. The economic turnaround is also bearing fruit on the labour market. In the first quarter of this year, employment surpassed its trough from late 2013 by almost 8%. Similarly, the unemployment rate decreased from roughly 28% in July 2013 to 19.5% in May 2018. At this level, however, it is still very high.

And this is not the only figure that shows that 20 August (end of the third adjustment programme) is not the finishing line, but a milestone on a long road to recovery. According to the latest Eurobarometer survey (Spring 2018), only a tiny fraction, namely 2%, of Greeks rate the current situation of their economy as good. Perhaps even more tellingly, all of the remaining 98% perceive the economic situation as bad. That contrasts strongly with a more or less even split of all EU respondents when asked about their respective economies.

All of this means that the economic recovery has not yet reached the population. To announce "mission accomplished" would be premature: the job is not done yet. Many observers have stressed the need for an even more ambitious reform agenda if stronger and more inclusive growth is to be achieved. Additional growth-friendly structural reforms would bring the economy onto a steeper growth path, and provide greater job opportunities and faster growth in productivity and real wages.

In this regard, I would like to highlight the particular importance of institutional reforms. Research has argued convincingly that institutions are key in determining different levels of prosperity in the long run. Moreover, legal efficiency could contribute to the public's feeling that the political and economic system is fair.

2.2 Banking system

A more prosperous economy would also help the Greek banking system to recover from the crisis. However, the severity of the problem of non-performing loans means it will not simply go away.

While the banks have demonstrated their willingness and capability to act by carrying out considerable write-offs and sales, I fully support what Yannis Stournaras recently told the

Financial Times when he said: "We need to be more ambitious in reducing non-performing loans. The banks should pursue sales of NPLs more intensively".[4]

In particular, a more efficient and liquid secondary market for non-performing loans (as called for by the Bank of Greece) would spread the risks among more actors. A swift resolution of the NPL problem would enable the Greek banking sector to fulfil its traditional role of providing credit to the real economy and allocating funds to the productive sectors of the economy.

2.3 Fiscal policy

Now, after the conclusion of the ESM programme, fiscal and economic policies in Greece will be watched closely. To quote Yannis Stournaras again: "The markets will take a tough approach." And to that I would add: you can't really argue with them.

Investors' confidence needs to be regained and maintained. This requires, amongst other things, an appropriate fiscal policy course. Thanks to agreed debt relief measures, liquidity needs will be rather limited over the coming years. Further protection is provided by the cash buffer.

The route to future prosperity for Greece could lie in proving in the years ahead that it can stick to a sound fiscal path and bring its debt ratio onto a sustained downward trajectory. In such a scenario, markets would become increasingly confident about Greece, and the growing impact of market financing would be bearable. This solid path may sound daunting. However, Greece is currently running a marked structural budget surplus, which means that no further fiscal contraction would be necessary.

3 The future of the euro area

Ladies and gentlemen

Allow me to come back to the aforementioned ancient agora: What was it that made it so economically successful as a marketplace for exchanging goods? Obviously, it confined sellers and buyers to a distinct space. This spatial concentration made it easy for merchants to find customers, while the latter could easily compare prices. Thus, the agora reduced transaction costs. However, such a market also creates a fundamental problem. Given the information asymmetry between buyer and seller, the latter has an incentive to cheat by providing goods of lower quality or in smaller quantity than agreed. Of course, the buyers will eventually notice the deceit and stay away from such a market.

The ancient Greeks found a clever solution to this problem: they established public institutions to improve and maintain market efficiency.[5] The city-state provided standardised weights and measures that merchants were obliged to use. For instance, the agora featured a stone table, the "sekoma"; it had several cavities which were used to measure different volumes. Special magistrates, the "agoranomoi", examined the quality of products and watched over the proper conduct of transactions. These market controllers made sure sellers and buyers were held accountable for their actions. They could impose fines – and carried a whip as a token of their authority. In addition, the city-states minted coins by putting a stamp on silver discs. In Athens, these coins bore the owls which have become synonymous with the city. Instead of weighing and arguing over the precious metal content, market participants could simply count these coins. The city-states guaranteed the quantity of silver and made the coins legal tender in the agora.

Of course, the provision of public goods needs to rest on healthy financing. The city-states incurred costs by setting up the agora, maintaining it and paying salaries to the magistrates. Thus, it was only fair that they also levied a sales tax ("to epónion").

Overall, the agora is a fine example of a set of clever institutions reducing transaction costs, aligning incentives, and thereby allowing markets to thrive. Nor is this lesson confined to the inner workings of any economy. It also applies to the European context.

3.1 Lessons learned from the crisis

The crisis has taught us that economic and fiscal imbalances in individual member states are not just a national problem. We learned in practice what one of my predecessors, Hans Tietmeyer, meant when he predicted more than 20 years ago that a currency union creates a fateful bond among its member states because interdependencies intensify dramatically. Indeed, we had to learn the hard way how quickly a local crisis can evolve into a euro area crisis.

Some observers have stressed the magnitude of the financial aid that Greece has received from other euro area member states over the past eight years. I do not intend to downplay these efforts. However, it would also be wrong to look on the assistance as an act of pure generosity. Underlying the solidarity was the realisation of our interdependence within monetary union and the imminent threat to the financial stability of the euro area as a whole.

According to the Maastricht Treaty, which set the foundations of economic and monetary union, economic and fiscal policies remain the responsibility of the member states. But such a set-up creates vulnerabilities. It intensifies the deficit bias, as it allows costs to be shifted, to an extent, onto others.

The founding fathers of the euro tried to provide for this well-known risk. They prohibited printing money to finance government deficits, they ruled out government bail-outs and they established an excessive deficit procedure. However, repeated breaches permanently impaired the fiscal rules. Germany was one of the main culprits here, as it – together with other countries – proceeded to water down the Stability and Growth Pact in the early 2000s. Moreover, the institutional set-up turned a blind eye to other macroeconomic and financial imbalances.

Overall, the framework could neither prevent nor manage a crisis. Given these institutional shortcomings, the euro area member states share responsibility for the emergence and escalation of the crisis in this respect. We were all caught on the wrong foot.

As you know, the Greek Loan Facility in 2010 was created on an ad hoc basis. The institutional framework has been adjusted and improved since then. One enhancement was to establish a permanent rescue facility. The ESM can grant conditional financial aid to member states, if needed, to prevent a national crisis from jeopardising the stability of the entire euro area financial system. Another substantial improvement was the launch of the banking union. In this context, the uniform supervision of banks in the euro area is an important step towards a more stable European banking system. And if a bank fails nevertheless, a clear liability hierarchy is now in place.

Together with stricter financial regulation, the banking union and the ESM have undeniably made the monetary union more stable. If there were new upheavals in the financial system or in individual member states today, the euro area would be considerably better equipped to deal with them than eight years ago. At this point, a particular quote which is ascribed to the Greek writer Plutarch seems appropriate: "To make no mistakes is not in the power of man; but from their errors and mistakes the wise and good learn wisdom for the future."

3.2 Further reforms needed

As a matter of fact, European policymakers learned from past mistakes and did things better. However, the achievements seen so far are not enough. There is consensus among experts that additional reforms are needed to further reduce the euro area's vulnerability to crises. Yet it is not clear which path to choose going forward. For some time now, an intensive debate has been taking place on the future structure of the monetary union. A number of concepts and proposals are on the table. They differ over the weight they each accord to risk sharing and joint liability on the one hand, and to individual responsibility, a rules-based regime and the avoidance of false incentives on the other.

Either way, however, it is crucial for the stability of monetary union that the liability principle is complied with. In a nutshell, it stipulates that whoever decides on an action must also bear the consequences of that decision – by reaping the benefits or suffering any disadvantage or loss. It would be neither fair nor sustainable if decisions could be made at the expense of others. Wrong incentives would be created.

For example, insurance can encourage the policyholder to take on more risks. This is the essence of moral hazard. And again, the ancient Greeks provide us with an illustrative example since they may have been the first to come up with a commercial insurance scheme.

Back then, unpredictable weather conditions and piracy rendered maritime trade a highly dangerous venture. But the ingenious Greeks invented rather complex contracts for a loan which could be used for equipping or repairing a ship and which would not have to be repaid if the ship was lost on its journey. If the ship made a successful return, the creditor received its principal plus massive interest on top, reflecting the risks involved and the insurance premium. However, if the loan exceeded the value of the ship, there was an incentive for the ship-owner to simply keep the loan and make off with it.

Thanks to a speech ascribed to the Athenian orator Demosthenes, we know of a certain Hegestratos.[6] He is said to have planned to sink his own ship during the journey – with all passengers and cargo on board. Unfortunately for him, he was caught in the act, jumped overboard and was not seen again. Nevertheless, the incident, which may have been the first case of insurance scam in history, led to a complicated legal dispute between an alleged co-conspirator and a creditor.

Fast-forward more than 2,300 years, the Maastricht framework was based on a clear understanding of the liability principle. Member states would remain autonomous in terms of their economic and fiscal policies. The flip-side then was the "no bail-out" clause. Both actions and liability were located at the national level and, thus, aligned.

Today, many Europeans call for greater risk sharing. If such a joint liability were established, corresponding sovereignty rights would need to be transferred to the European level, too. Otherwise, the set-up could contribute to a possible resurgence of unsound developments. However, my impression is that the willingness to cede sovereignty rights to Brussels is rather limited in most of the euro area member states. For the time being, therefore, reforms must fit within the existing Maastricht framework.

But that does not wholly rule out elements of joint liability. I concede, for example, that a common deposit insurance could contribute to a more stable financial system, as it would reduce the risk of bank runs.

However, the balance between actions and liability requires that risks that arose under national responsibility cannot be mutualised. They would have to be reduced before the scheme is established. If not, a common deposit insurance would lead to a redistribution of inherited risks.

I am thinking here of the high stock of non-performing loans, but I am also thinking of sovereign exposures in banks' balance sheets. Since the debt crisis, we cannot go on pretending that sovereign bonds are risk-free assets. And that is why the Bundesbank advocates putting an end to the preferential treatment of sovereign debt in banking regulation. The wrong incentives implied should be reduced – gradually, of course. In any case, we need to avoid a situation in which banks are highly vulnerable because they have stockpiled huge amounts of sovereign bonds.

In the current reform debate, many concepts involve new fiscal facilities. For example, it is argued that a euro area budget would promote competitiveness and convergence of euro area member economies. However, such a budget could be counterproductive if it raises the fiscal burden weighing on European citizens. Moreover, it should not create new opportunities for public borrowing, given already high debt levels. On the other hand, if it is part of a fundamental reform of EU funds, a euro area budget could be a welcome development.

3.3 A strong euro area as part of a strong EU

Ladies and gentlemen

at the World Cup football tournament in Russia, European teams were very successful. Admittedly, the Greek national team didn't qualify and the Germans failed miserably. But the last four teams were all from EU member states. When Brazil became the last non-European team to drop out of the competition, our former national goalkeeper, Oliver Kahn, remarked on German TV: "Well, at least we have a strong Europe at the World Cup." It was just a witty one-liner, but of course he was not totally wrong.

We need a strong European Union beyond the football pitch. In fact, I would say we need it more than ever. Europe is facing serious challenges: the reform of the euro area, the refugee crisis, the Brexit negotiations, international trade conflicts, and various geo-political tensions. Events and developments of the recent past underpin the necessity to act in close cooperation. We have to work together, based on our common values. These values on which the Union is founded include respect for human dignity and human rights, freedom, democracy, equality and the rule of law.

However, a strong European Union calls for workable institutions and a clear focus. The EU needs to concentrate on tasks which can be better performed at the European level than the national – tasks that offer clear European added value. Areas in which this added value may be found include defence, the protection of external borders, migration policy, climate protection or the expansion of digital networks. A common asylum policy driven by a spirit of solidarity, for example, would also help individual member states to feel less disadvantaged and abandoned on account of their geographical location. On the other hand, the tasks that can be better handled domestically than at the European level should be re-allocated to the national or regional level, in line with the principle of subsidiarity enshrined in the EU Treaty.

Focusing the EU in this way would help making Europe stronger.

4 Conclusion

Ladies and gentlemen

The ancient agora can teach us several important lessons. For one thing, it provides early evidence that markets function more efficiently if the state sets an incentive-compatible framework in terms of smart regulation and law enforcement. The liability principle is essential. And institutions matter. That was true for the functioning of ancient marketplaces and that is true for the economic and monetary union.

"The whole is greater than the sum of its parts." This sentence, which is attributed to Aristotle, concisely sums up the idea of European integration. In this context, Greece is more than the cradle of Western civilisation: it is very much a part of Europe, and a prosperous Greece will contribute to making the whole greater.

A more stable economic and monetary union is in our common interest. Much has been done – in the member states as well as at the European level. These days, a shock similar to a sovereign debt crisis would not find the euro area as ill-prepared as it was in the past. But the euro area is not yet fully crisis-proof. There is still need for further action. However, making the euro area more stable does not require us to decide between solidarity and solidity. The opposite is true: we need both solidarity and solidity.

Σας ευχαριστώ πολύ.

Thank you very much for your attention.

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1 P B Shelley (1821), Hellas, preface.

2 K R Popper (1963), Conjectures and refutations: the growth of scientific knowledge, published 2002 by Routledge, p. 501.

3 J Gauck, Europe: renewing confidence – strengthening commitment, speech on the prospects for the European idea, on 22 February 2013 at Schloss Bellevue.

4 J Brunsden and K Hope, Athens told to stick to reforms or risk losing vital investment, Financial Times, 31 July 2018.

5 See A Bresson (2016), The making of the ancient Greek economy – institutions, markets, and growth in the city-states, Princeton University Press.

6 See, for example, D M MacDowell (2004), Demosthenes, Speeches 27–38, Against Zenothemis.