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Book Review: Economic Policy Coordination in the Euro Area by Armin Steinbach[1]

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More than six years ago, the Eurozone crisis broke out. Some, but not many economists had seen it coming. Today, Europe still suffers from continuing woes. But do economists at least know (better) what kind of policies would have prevented the crisis? Which measures help dealing with it? And what steps would avert equally disastrous consequences in case of renewed shock waves from the real economy or the financial sector?

This kind of questions must have motivated Armin Steinbach to assess the Eurozone's macroeconomic framework within his book *Economic Policy Coordination in the Euro Area*. The ongoing economic crisis, particularly the one in Europe, has also been perceived as a crisis of the economic profession. Steinbach's contribution is a serious attempt to end both of them. Since the beginning of the crisis, numerous rather general proposals for a revised European economic policy framework have been broadly disseminated. These have for instance foreseen a dismantling of the Eurozone, or, alternatively, the introduction of joint fiscal policy instruments such as joint bonds or joint automatic stabilizers. However, there seems to have been a lack of advice that would take into account feasibility, implementation as well as political implications of the proposed economic strategies. A lack of advice that would fit into the legal framework of the EU, the Euro Area and its member states, as well as their respective political circumstances. This suggests that, in search of the silver bullet for the European economy, horizontality and the integration of other disciplines' results has been weak. The lack of horizontality has gone even deeper, leading in many cases to incompatibility between advice given by macro- and microeconomists. I will get back to this later.

The apparent shortage of tailor-made advice to European policy makers thus calls for multidisciplinary approaches that take into account the disciplines of institutional economics as well as of law and economics. Armin Steinbach is well placed to deliver – and to break the silos. Trained as a lawyer as well as an economist, he has experience in both science and policy making. And indeed, *Economic Policy Coordination in the Euro Area* is a book that looks at the Euro crisis and the development of institutions in Europe from a multidimensional perspective: Steinbach assesses recent years' reform efforts from an economic as well as a legal and political point of view. While tackling European issues as a whole, he chooses to a large extent a German focus, gives examples from Germany and discusses questions related to German – national – policy choices. This is not necessarily expected from the book's title, but can nevertheless be considered as justified, given Germany's size and its importance in the Eurozone as well as in European decision-making.

[1] Routledge, Milton Park / New York, 2014, pp. 202, hardback, 90€

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Steinbach introduces economic policy coordination, in a traditional sense, as the coordination between the classical forms of macroeconomic policies – fiscal, monetary and wage policy. He considers cross-country spillovers within these policy areas in the European monetary union, as well as spillovers between policy fields. This kind of classification – Steinbach defines the former as cross-border and the latter as cross-policy spillovers – is extremely helpful indeed and constitutes a major element of the analysis.

This tool could furthermore be applied outside of the specific context of economic policy in the Euro Area and help identifying blind spots in policy coordination in general. Also from a technical point of view, extensions are conceivable. While Steinbach chooses a pragmatic two-dimensional perspective by looking at spillovers between policies as well as between countries, those aspects could moreover be combined in a three-dimensional way. This would help assessing whether there are externalities or spillovers between policy A in country B and policy C in country D; for instance, between wage policy in Germany and fiscal policy in France. In the context of the Eurozone's economic policy coordination, this might be a comparably minor aspect. It could however have more relevance when applying Steinbach's framework to other fields.

Steinbach sees the Eurozone as being heterogeneous and far from an optimal currency area, making it vulnerable to asymmetric shocks. Employing his analytical framework of externalities and spillovers, Steinbach argues that externalities between countries as well as between policies exist. Macroeconomic coordination before the outbreak of the Euro crisis had been weak, and to his opinion underdeveloped. In particular, he builds on arguments developed by Alberto Alesina and coauthors that, in the Eurozone with its joint monetary policy, the ECB is better suited to deal with symmetric rather than asymmetric shocks. Tackling the latter, argues Steinbach, should therefore fall within the remit of fiscal policy.

An in-depth analysis on existing and possible future European policies constitutes the centerpiece and highlight of Steinbach's book. Here, he is listing in detail how policies have changed in light of the crisis, and he gives a critical assessment of what has been achieved and what hasn't. Steinbach makes the case that in particular fiscal policy coordination has moved forward, for instance with the Macroecoonomic Imbalance Procedure and the Fiscal Compact. He considers the current framework nevertheless as too soft and decentralized, arguing at the same time for less power for national governments as well as for more severe punishment in case they don't stick to the common rules. In assessing possible additional steps towards a more coordinated fiscal policy in Europe, the author is in favor of going further in the direction of a fiscal compensatory mechanism or a joint unemployment insurance, but he also describes in detail considerable implementation problems.

In this sense, Steinbach's assessment suggests two *inconvenient truths* that deserve more attention: Firstly: Asking for a more active fiscal policy across European countries that would not go hand in hand with some form of joint liability can be seen as fiscal brinkmanship. Several Eurozone economies are still vulnerable or might become it (again) for different reasons in the nearer or more distant future. Increasing deficits would *ceteris paribus* fuel these vulnerabilities. A joint fiscal capacity (or a lender of last resort) might be a *conditio sine qua non* for a significant increase in fiscal flexibility across Europe. Otherwise, in order to prevent from a renewed government debt crisis, fiscal policy might need to stay prudent. Secondly: A more coordinated fiscal policy or even a phasing in into a joint fiscal capacity alone might alleviate, but will nevertheless not end the pain of adjustment in fiscally fragile Eurozone member states: Those countries would still need to continue improving efficiency, cutting expenditures or raising tax receipts for years or even decades. Steinbach highlights that for instance the European Redemption Pact proposed by the German Council of Economic Expert foresees long-term debt repayment paths that would thus raise the question of time (in-)consistency. A question that has further come to the forefront in early 2015 – in light of the discussions around the Economic Adjustment Programme for Greece.

Apart from that, Steinbach's discussion of fiscal policy in federal versus union states is interesting and relevant on its own and might also be applied to reforms of national fiscal frameworks. However, the author's analysis makes clear that further research will be needed on the complex issue of fiscal institutions in Europe. Taking seriously Steinbach's proposition to change the European fiscal framework, further considerations on the definitions of deficits and debt could seem straightforward. What are advantages and disadvantages of focusing on structural deficits and gross government debt, thereby, for instance, raising analytical (e.g., as regards business-cycle adjustments) as well as purely logical challenges (for instance regarding the consideration of contingent liabilities and government assets)? Given that Steinbach advocates clear rules for state insolvency, scholars might consider it moreover worthwhile to analyze parallels as well as the interplay with the European banking sector and its regulatory environment.

As regards European monetary policy, the author argues that the ECB's approach has shifted from a once strict monetarist separation of functions to some form of cross-policy coordination with fiscal policy through the ECB's involvement in the troika and, later on, the so-called institutions. Steinbach further takes note of some cross-border coordination of wage policy through cooperation between trade unions, but nevertheless reckons that wage policy represented the most underdeveloped form of policy coordination. He expresses his skepticism about whether increased coordination in wage policy was feasible in the short or medium run; even a prerequisite for such European approach, namely a harmonization of national wage-setting agreements, seems unrealistic to him. The strength of Steinbach's analysis of wage policy is the compilation of evidence with regard to Europe-wide cooperation between trade unions. It would have been interesting, but beyond the scope of the author's study, to combine this inquiry with a critical examination of the role of wage policy in internal imbalances of the Eurozone. Steinbach provides some evidence on labor costs and their possible impact, but largely abstracts from factors related to so-called non-price competitiveness. These factors are not only much more difficult to measure than wages – this might be one reason why they are less present in the European competitiveness-debate – but probably also more difficult to tackle from a political perspective: Reducing or even eliminating cross-country differentials might require a complete overhaul of institutions in some of the least competitive member states. Also in this domain, economists still have some way to go in the coming years, no time for academic complacency!

Turning back to Steinbach's work: In a nutshell, one has to praise the author's extremely detailed analysis that goes straight into the heart of European procedures and mechanisms. Moreover, while the author underlines his support for the traditional concept of economic coordination, he nevertheless extends it to a certain extent. When discussing progress of centralization within the Eurozone, he devotes much attention to coordinated structural reform efforts, even though these do not form part of the original definition of macroeconomic coordination. Steinbach has very much a point here. Indeed, supporting the coordination between fiscal, monetary and wage policy based on theoretical argument doesn't exonerate from raising the million dollar question: *How much* can this kind of coordination contribute to ending the economic weakness in Europe? The answer is closely linked to the question whether in the end, the current problems in Europe are of cyclical or structural nature, and whether they can be solved with, on the one hand, demand stimulation, and on the other hand, structural reforms. It seems obvious that macroeconomic coordination does not help much in times of a productivity slowdown that has been structurally induced, e.g. via domestic overregulation. Likewise, structural measures will provide insufficient stimulus during a cyclical slowdown.

If one, as many economists, came up with the diagnosis that Europe suffers from a both structural and cyclical weakness, this would accordingly call for a combination of policies – a package of structural as well as cyclical responses. In such setting, the question of a sensible interplay and of complementarities between those measures arises: Which kind of structural reform in which parts of the Eurozone can support what kind of fiscal, monetary and wage policy in the same and other parts (with interest rates of course being homogenous across the Eurozone, while other monetary policy do not necessarily need to be identical across member states)? And what kind of institutional arrangements are necessary – to allow for such a comprehensive policy package being implemented – as well as stable over time?

In this sense, and in the end, Steinbach's analysis suggests – although in a rather subtle way – that not only pre-crisis economic policy has failed. The concept of macroeconomic coordination in its traditional form has some merit, but might in the end not be a panacea for dealing with the multifaceted economic crisis in the Eurozone, the European Union and their complex institutional structures. From a scientific perspective, an even broader view on economic policy is needed – one that takes aspects of several (sub-) disciplines into account: Macro- and microeconomics with their different schools and varieties, as well as approaches that go beyond the economic discipline. Steinbach's work is a step in this – right – direction. The book is intellectually stimulating and will hopefully constitute a starting point for an even more integrated view on economic policy – for Europe and beyond.