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# What is the role of the GCEE?

*The Council of Economic Experts is an academic body advising both German policy makers and the general public on questions of economic policy. It was set up by law in 1963 with the objective to assess the macroeconomic development of Germany. Furthermore, the GCEE aims to aid all public and economically relevant institutions in making informed judgments about economic developments. It enjoys complete independence with respect to its monitoring and advisory activities. The Council's reports and assessments have since become an essential part of German economic policy making and have notably influenced political decisions. Prof. Dr. Christoph Schmidt gave us this interview two years ago, after Germany hosted the G7 summit on 7 - 8 June 2015 in Schloss Elmau. Some African leaders were invited. The interview was first published in the July 2016 issue of Hommes d'Afrique magazine French version. Since then, our English speaking readers have been asking for the English version, that we are offering them here, on the occasion of Germany G20 summit and German government's constant interest in Africa. An interest that the German Compact With Africa (CWA) exemplifies.*

**The GCEE was created by a German law in 1963. That was 17 years after a US law had established the US Council of Economic advisers (CEA). Was the GCEE modeled on the CEA? What distinguishes the GCEE from the CEA?**

In the second half of the 1950s, the German government, in particular Ludwig Erhard (vice chancellor since 1957 and chancellor since 1963), was concerned about the increasing social



and distributional demands by policy makers and labor unions. As a result he saw an increasing risk for monetary stability and thus for sustained economic and employment growth. He therefore stressed the importance of having an independent institution that informs the public and the government on macroeconomic relations and thus contributes to a more objective evaluation. Consequently, the GCEE was created as an independent institution and not as a part of the government. In contrast, the CEA is an agency within the Executive Office of the President.

**Germany appears not only as**

**the strongest European economy, but as a world industrial and trade power. If you were to give three reasons explaining this double German success, what would you say?**

Germany's remarkable post-WWII recovery rests on several fundamental aspects. First, the German education system provides a broad and quite equitable foundation for economic activity. Second, the German economic structure comprises a healthy mix of large and small companies whose everyday business heavily relies on the social partnership between employers and wor-

kers and which compete successfully on world markets in their area or niche. And third the German social and economic system of a “social market economy” rests on a fruitful balance of ascertaining efficient markets and retaining a highly equitable income distribution through a redistributive system of taxes and transfers. While the balance between these two facets of efficiency and equity tended to tilt towards more redistribution over time, Germany has recently readjusted the balance successfully, in its “Agenda 2010” reforms. This is one of the reasons why Germany has fared so well in the recent economic crisis.

**The latest OECD Economic Survey of Germany, published in May 2014, observed that in Germany, «the share of low-paying jobs has risen considerably» and that Germany’s «potential growth is estimated to fall on account of demographic changes over the next 20 years». What are your comments? What policy does GCEE advise against this double challenge?**

It is easy to misunderstand the state of affairs, if one is looking on wage developments in isolation, as the OECD is doing in this statement, disregarding the highly effective German system of poverty relief. But let me start with the point that has my unequivocal agreement: the demographic development, in combination with rapid technological changes and increasing international competition, is the most important challenge for the German economy in the decades to come. This challenge calls for measures to increase productivity, in particular via education and innovation policy. Germany must also continue to strengthen labor market participation, especially of the older population.

In both cases, sufficient flexibility is needed in order for the economy to adjust. Since the mid-2000s, after a number of structural reforms, including the labor market, the social security, and the tax system, the German labor market has improved markedly. Many low-skilled

workers found new employment in the low-wage sector. This is sometimes labeled the «German labor market miracle». At the same time, income inequality has remained stable: In international comparison, the inequality of disposable income after taxes and transfers is well below the OECD-average.

The reason underlying this desirable combination of outcomes – declining unemployment, increasing employment rates of low-skilled workers and nevertheless a stable distribution of disposable incomes – is the German system of poverty relief: It supplements incomes according to the family situation, irrespective of (hourly) wages. This effectively decouples labor market success and income, and ascertains that those who are working receive more income than those being out of employment.

**For the past five years, Germany has been and continues to be the major player confronting the crisis in Euro area. This crisis reached a peak on 11 July 2015, with a last minute agreement that avoided Grexit. On 28 July 2015, the GCEE released a special report titled: «Consequences of the Greek crisis for a more stable euro area». What are the key messages of that report?**

The crisis in the euro area has revealed fundamental problems in the design of the single currency area that led to crises and prompted important reforms and adjustment programmes in some heavily affected countries. These measures were quite successful in Ireland, Portugal and Spain, but not yet in Greece, which lags behind in terms of recovery. Yet the situation in Greece should not be taken as proof of failure of the rescue policy. Instead, the report argues that consolidation and structural reforms are the only viable avenue to recovery within the monetary union, and emphasizes the need to make the euro architecture more stable to prevent further crises.

To provide such a stable framework, the GCEE developed a concept “Maastricht 2.0”. The reforms of the recent years – in particular the reform of the fiscal fra-

mework, the introduction of the ESM as crisis mechanism, and the establishment of a banking union – were largely consistent with this concept. But, some reforms remain incomplete: The banking union needs to be strengthened and the problem of the bank-sovereign nexus has yet to be fully solved. For the no-bailout clause to become credible, an insolvency mechanism needs to be created. And if a member country continually fails to cooperate, a country’s exit from the Monetary Union must be possible as a last resort.

**Do you see the 11 July 2015 agreement as a good one for Greece and for the Euro area? Why?**

With the 11 July 2015 agreement and the third aid package there is a certain chance for Greece to manage the turnaround and at the same time remain a member of the euro area. If we succeed in preserving the common currency area, great damage would be prevented, not least from Germany. So I think the decision to prevent a “Grexit” at this time was appropriate.

**The GCEE report insists that «the institutional framework of the single currency area can only ensure stability if it follows the principle of unity of liability and control». Could you elaborate on that?**

All reform proposals must withstand a critical evaluation of the incentives they set for national economic and financial policy. The institutional framework of the single currency area can only ensure stability if it follows the principle of unity of liability and control. This principle states that decision powers must be located at the same governmental level as the responsibility to bear the consequences of such decisions. For instance, national decisions of fiscal policy must not prompt other euro area members to foot the bill. Reforms that stray from this guiding principle plant the seeds of further crises and may damage the process of European integration.



**Some European leaders, including François Hollande of France the creation of an Euro zone economic government as a solution to that zone's chronic problems. The GCEE radically opposes this solution as well as other proposals such as the «European Employment Insurance» and the idea of fiscal transfers between one Euro area country to another one. Why this opposition?**

It has become evident in the past years that the euro area member countries are unwilling to give up national budget autonomy. Hence, without the transfer of national sovereignty over economic and financial policy to the European level, any setup resembling an euro area economic government would likely violate the principle of unity of liability and control.

The same holds for the proposal of a European unemployment insurance. National unemployment insurance schemes are structured very differently, for example in terms of benefit amounts,

eligibility requirements and the realm of workers being insured. More than any other policy area, the structure of the social and labor market policy lies purely in the interests of each member country. The reasons for unemployment are not exclusively cyclical but also structural; an European insurance mechanism would then lead to permanent transfer payments. Actually, France desperately needs national labor market reform, regarding its high minimum wage and its low standard working time. This is not a matter to be pushed onto the shoulders of other Euro members.

**As the GCEE were releasing its report, the Halle Institute for Economic Research, which is member of the Leibniz Associations, published a study titled «Germany's benefit from the Greek crisis». According to this study, Germany benefited some 100 billion Euros from the Greek and Euro crisis, between 2010 and 2015. This sum is**

**largely superior to 90 billion Euros, the total amount of all Greek direct and indirect debts to German government. What is your reaction to this study?**

It is highly unfortunate that today's media attention rewards catchy headlines and tends to disregard intellectual rigor. The statement you quote is actually devoid of economic meaning, as Germany comprises many distinct economic actors which have fared quite differently in the crisis. It is true that the German government in some way benefits from the Greek crisis, as it can refinance itself quite cheaply. But at the same time many savers in Germany suffer from the low interest rates. Overall, I simply believe that most relevant actors including the government would have preferred a world without this crisis. From that perspective the quoted title is actually ludicrous.

**A whole chapter of the GCEE is devoted to «Instability due to premature integration steps»**

## **toward the single currency. Do you mean the Euro as a single currency was prematurely created?**

Of course, with the experience of the crisis in the Euro area in mind, one would hesitate – hypothetically placed some 20 years ago – to create the Euro area in the same form and with the same architecture once again. But this is not the issue. Our considerations instead start from the actual situation and ask what alterations should be made to the current architecture of the monetary union in order to eliminate its structural deficiencies. What is important is that the euro area rests on an appropriate policy framework which includes effective fiscal rules, an insolvency mechanism for states, as well as a banking union with joint supervision. What would be premature from the vantage point of the current state of affairs would be the creation of a Euro area economic government, since this would not adhere the principle of unity of liability and control.

## **Some critics of Euro say Euro is not a sustainable currency, because a monetary union cannot, on the long run, survive without a political union. What is your answer to these critics?**

This is a statement which you can indeed hear often, but where is the evidence? The European integration process is wonderful in its quest for peace and economic prosperity. In my assessment it is very well possible to continue along this route, even though Europe is so diverse in such a large number of aspects. It is possible, because sovereign countries can agree on a set of binding rules which are a powerful device of overcoming national differences. Consequently, a monetary union without a political union is possible as long as every country is compliant to these rules. In the case of the Euro, this seems to be the only way as long as the member States do not want to give up their sovereignty over their budgets and their economic policies.

## **Does it make sense for countries**

## **with economic and demographic profiles as different as those of Germany and Greece, to share a single currency?**

It was clear from the outset to all rational observers that the poorer members of the new monetary union would have to adjust their economic structures quickly to be able to converge in terms of economic competitiveness to the stronger economies in the currency union. Convergence of living standards was

***What would be premature from the vantage point of the current state of affairs would be the reaction of a Euro area economic government, since this would not adhere the principle of unity of liability and control.***

never meant to be a matter of financial transfers. This, of course, requires a strong commitment from all participating countries to this fundamental idea of self-reliance. So far, Greece had not displayed serious signs of understanding this commitment.

## **A group of 16 African countries share a single currency: the CFA franc. This currency is tied to the euro by a fixed peg that makes those countries a de facto subset of the Euro area. What is the economic rationale for the CFA franc - Euro fixed peg?**

In particular for small countries a fixed exchange rate vis a vis the main trading partner is an attractive option, since it creates stable conditions for exporters and importers as well.

## **Who benefit from the CFA franc -Euro peg? Africans or Europeans or more specifically**

## **France?**

In most cases, the smaller partner benefits most from such an exchange rate arrangement. Whereas the importance of the CFA-countries in EU exports as well as imports is very small, the EU is a rather important trading partner for the CFA countries. However, fixing the exchange has its price. Since the exchange rate mechanism is not at hand to adjust inflation differences, policies in the CFA countries must be directed at keeping inflation low.

## **The German government hosted the G7 summit on 7 - 8 June 2015 in Schloss Elmau. Some African leaders were invited. In the perspective of the Sustainable Development Goals that the UN General Assembly will adopt this September 2015, that summit discussed a Development Agenda. As the German government economic adviser, what has been GCEE contribution to that Agenda? More generally, what are GCEE's advices to German government in her economic relations with Africa?**

The GCEE contributed indirectly to the Agenda. With the collaboration of the French Conseil d'Analyse Économique (CAE), the GCEE published a report on "Monitoring economic performance, quality of life and sustainability". Sustainability developments are an important focus of this report. Furthermore, the Enquete-Commission of the German parliament on which I served as a member published a report on "Growth, prosperity and the quality of life – towards sustainable management and social progress in the social market economy". These reports served indirectly as additional documents for the Development Agenda at Schloss Elmau. So far, the GCEE has not explicitly expressed advices on economic relations between Germany and Africa. In the annual reports of the GCEE the analysis of the global economy plays an important role. Within this section the economic spillovers of developing

and emerging countries to global economic activity are also described and evaluated. The influences of the Arab Spring depict an example (GCEE's annual report in 2011/2012) where developments in Africa have been mentioned. Incidentally, the research institute which I am heading as President, the Rheinisch-Westfälisches Institut für Wirtschaftsforschung (RWI) intensively works on evaluating electrification and other measures to foster development in Sub-Saharan Africa.

**After having planned to abandon nuclear energy and to diminish hydrocarbon energy plants in its energy mix, Germany is a world leading country in clean energy. This is an important position given the upcoming international climate summit COP21 in Paris, next December. What economic and financial mechanisms, and what production and consumption incentives are in place in Germany to favor clean energy?**

Unfortunately, in pursuing a highly valuable objective, the decarbonisation of its economy, Germany has chosen a highly inefficient route which concentrates on a national approach to climate policy and disregards fundamental economic considerations. Germany heavily subsidizes the production of green electricity via so-called feed-in tariffs, at the expense of consumers who have to bear the tremendous cost by paying higher electricity bills. In terms of cost, this is Germany's biggest subsidization mechanism since the second world war. This is so unfortunate, since the same progress could have been achieved at much lower cost, and the "Energiewende" is still far from being a success.

**With two of your colleagues, you published last year a paper titled «Germany's solar cell promotion: An unfolding disaster». This is a strong critic of the German Renewable Energy Act. Why this critic?**

This criticism is due to the massive

subsidies of more than 100 Billion Euros for photovoltaics (PV) alone. PV is thus the most privileged alternative technology in Germany, while its share in total electricity production is as low as roughly 5%. Increasing the share of renewables in electricity production could have been realized with much less money by implementing a technology-neutral subsidization mechanism, rather than the Renewable Energy Act. With such a superior subsidy scheme, much less expensive renewable technologies would have been installed, rather than the very expensive PV.

**What minimal decisions must be taken at COP 21 to make it a success, after the failures of past similar summits, for instance the 2009 Copenhagen summit?**

It is no surprise that former COPs failed, as it is unlikely that the most important nations agree on emissions limits that hamper their economic growth. This is simply the wrong way! More promising would be to include ever more countries into the European system of trading CO<sub>2</sub> emissions, until a global alliance against climate change is realised. But for this to become reality, one would have to compensate those economies which would forego economic progress by joining the mechanism. Helpful would especially be an agreement on R&D quotas to foster technological development, not least that of alternative technologies.

**Mr. Peter Bofinger, one of the five GCEE members, wrote a dissenting opinion against the GCEE «Consequences of the Greek crisis for a more stable Euro area» report. The last «E» in «GCEE» means «Experts». If economics is a science, how is it that within a group of expert economists, diverging if not opposite solutions are found to the same problem?**

Diverging opinions come about in the social sciences, not least in Economics, because often there is a severe lack of precedents for given questions of economic policy. Diverging opinions are

then an expression of the autonomy of scientific thought and nothing else than a reflection of Economics being a science. The opportunity to express different views demonstrates the overall autonomy and independence of each GCEE member. Moreover, diverging opinions are useful for discussions, both for the public as well as policy makers.

***In his 1844 book «Some unsettled questions of political economy» John Stuart Mill defined «political economy» or «economics» as «The science which traces the laws of such of the phenomena of society as arise from the combined operations of mankind for the production of wealth, in so far as those phenomena are not modified by the pursuit of any other object.» As an expert economist, what do you say about this definition? How would you define economics?***

Economics is a social science which is indispensable in the spectrum of social sciences, since it views human behavior from a perspective of individual incentives under conditions of scarcity. Applied economics is the quest of improving human lives by preparing rational and informed decisions.

***In addition to being the Chairman of the GCEE, you are also the President of the Rheinisch-Westfälisches Institut für Wirtschaftsforschung (RWI), Essen; and a member of the Scientific Advisory Board for the influential German government's strategy "Living Well – What's Important to Us". What is this strategy? What are you trying to achieve in all these institutions?***

My main goal is to improve decision-making in economic policy by informing policy makers and the general public, by providing evidence-based policy advice. My work in these institutions addresses several facets of this overall ambition.