Europe’s bank needs nous as well as rigour

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Three years ago, on August 9 2007, the European Central Bank shocked the world. As the global financial crisis first blew up, it acted quickly to provide emergency liquidity, pumping in €95bn. The surprise was not so much that rescue action was needed, but that the Frankfurt-based ECB had taken the global lead. Stuffy European institutions were not supposed to be as nimble.

With Europe’s banks already then in the eye of the storm, the ECB was fortunate to have an experienced crisis manager as president. Jean-Claude Trichet had handled financial market turmoil since his days as a French treasury official in the 1980s. Trained initially in mathematics and physics, and with a passion for poetry, Mr Trichet has since that fateful day overseen undreamt-of steps by the ECB to shore up the eurozone’s banks and economies.

In contrast, the US Federal Reserve and Bank of England have been led through the crisis by economics professors. Ben Bernanke is a world authority on the Great Depression; Mervyn King has a lengthy list of research publications on public finances and financial markets.

So far, it is not clear that the economics professors have fared better. But as the world emerges from the traumas of the past three years and discussion starts on a successor to Mr Trichet, whose term expires in October next year, is it time for an academic economist to take the reins at the ECB?

The case in favour is that a central bank needs a clearly understood way of thinking about how its economy functions, of its own role and options. Investors, businesses and consumers have to know how a central bank will react in different circumstances. If a central banker has an academic background it guides how he or she might behave. In the US, Mr Bernanke is known to be versed in the exceptional measures needed to avert disaster.

Until three years ago, the ECB was also easy to predict. The euro’s monetary guardian had been given just one main objective: controlling inflation. With its way of thinking inherited largely from Germany’s ultra-conservative Bundesbank, the ECB was expected always to err on the side of caution.

But from that day in August 2007, the ECB stopped being boring. Mr Trichet saw faster than others the need for improvisation. While he won plaudits for quick thinking, Mr King was criticised for hesitating to inject liquidity in the UK banking system and worrying over “moral hazard”.

The price was a loss of predictability. During this year’s crisis over eurozone public finances, even members of the 22-strong ECB governing council have been surprised at the extent of the measures they have taken and the shibboleths that have fallen. Early in May, the ECB dropped the principle of equal treatment for all member states to exempt Greek government bonds from minimum credit requirements on collateral used in its liquidity-providing operations. It went on to intervene directly in government bond markets.

Looking ahead, does anyone really know how the ECB would react if, say, the global economy went into a “double dip” and the eurozone lurched into a deflationary recession? Would conservative voices on its governing council prevail? Or might it go even further than before in taking exceptional measures?

The problem with having an economics professor as the next ECB president is that while the answers might be more predictable they might also be inappropriate. Axel Weber, the Bundesbank president and contender to succeed Mr Trichet, was an economics professor in Frankfurt, Bonn and Cologne. He has a distinctly conservative world view. The question is, would he be as bold as Mr Trichet in reacting to a crisis? He opposed for instance intervening in government bond markets.

A further potential challenge for a successor is that the post requires powers of advocacy. ECB decisions are taken by consensus in a governing council comprising representatives from 16 countries. So powers of persuasion are needed, particularly given that the ECB now has duties beyond textbook central banking. While in Washington and London the government and central bank broadly share a perspective the ECB has a more global vision than Brussels or other national capitals. During the crisis, this has played to Mr Trichet’s strengths.

Europe's monetary union, launched in 1999, was always a political project, the result of Helmut Kohl's desire when German chancellor in the 1990s to deepen Europe's integration. The reflections of Otmar Issing, a former economics professor and Bundesbank official who was the ECB's chief economist until 2006, give the impression of someone who knew how the eurozone worked in practice – but did not understand how it worked in theory.

Of course, the eurozone's economic flaws have been exposed this year. But patching up the monetary union took cunning. In the absence of a single political authority, Mr Trichet took the initiative in urging bank and country rescue packages and fiscal austerity by governments. Analysts who looked at the economics assumed the eurozone's break-up was inevitable, overlooking the political will that binds it. To marshal it through the next decade is going to require great political skills as well as economic vision – a tall order.