The Danger of Consensus

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Is consensus evidence of truth? While that may be correct in the natural sciences, in the social sciences consensus can easily be manufactured. In the absence of conclusive evidence, the returns on adhering to the prevailing opinion are high. The consensus view generally shapes the framework of public calls for research proposals, meaning one is more likely to get funding. And the biggest risk is to have been wrong like everybody else, which costs little in a world where academics are evaluated relative to their peers. The system of peer review in research naturally breeds consensus: reviewers who subscribe to the conventional wisdom have no interest in accepting new research that challenges it, as it would harm their career by rendering their own contributions obsolete. In a research community plagued by consensus, it is impossible for knowledge to progress dialectically, by rejecting paradigms and replacing them with more useful ones. Instead, knowledge only progresses horizontally, as a flow of aesthetic variations on the same themes is being produced.

It takes a great deal of courage for a prominent professor to disregard consensus; such a person provides an invaluable service to the research community at the risk of bearing high personal costs such as being ostracised or ignored. It is this service that Hans-Werner Sinn has given us throughout his prolific career.

Prior to European Monetary Union, many economists were sceptical about the single currency. Calculations suggested that the euro area was unlikely to be an optimal currency area. Countries diverged in their fundamentals and policies. Yet after the introduction of the euro a consensus emerged that EMU was irreversible. Discussions among European macroeconomists focused on how to improve the working of the monetary union through better fiscal policy coordination, structural reforms, or transfers. Challenging the whole scheme was a sure way to be treated as a maverick. It was generally considered that the costs of a given country of leaving the euro would be huge, although no such event has been observed yet, and despite the fact that a number of Southern European countries seem to bear a huge cost for staying in the euro area.

Consequently, this consensus generated substantial support among economists for policies that would commit to do 'whatever it takes' to maintain the common currency, such as OMT and other non-conventional measures. Issues such as the constitutional legitimacy of asset purchases, or whether implicit fiscal transfers were implemented between member states by a non-elected entity, were largely set aside. Similarly, not much importance was accorded to the distortionary effects of these policies on asset prices and the risk of initiating another bubble followed by another bust. The only thing that mattered is that asset purchases pinned down the value of public debt issued by troubled countries, thus allowing the euro area to buy time.

It is in this context that Hans-Werner Sinn wrote *The Euro Trap*. The book is an indictment of the whole euro project by a former enthusiast, who is not afraid to pour oil on the fire and making enemies in Brussels for the sake of intellectual honesty. In this book Sinn argues that European Monetary Union set the stage for catastrophe as capital massively flew from the richer euro area countries to their poorer counterparts. This capital inflow triggered a boom in countries like Spain, Greece and Portugal, which, in turn, led to persistent inflation differentials and a loss of competitiveness. This was impossible to combat with now abolished national monetary policy. And it continued as long as financial markets ignored the possibility of sovereign default and were willing to lend at the same low interest rate throughout the area.

This unsustainable golden age came to an abrupt end with the outbreak of the financial crisis. Sovereign debt spreads widened, fuelled by the expectation that

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some countries might leave the euro and by the recognition that adjustment would be very costly should those countries stay in the euro. The crisis was put to an end by the ECB, which essentially committed to buy the troubled countries' sovereign debt at some minimum price. The policy is viable as long as the value of the euro does not fall to a level that would trigger an inflationary spiral and a temptation to exit on the part of richer countries like Germany and Finland; and as long as the fiscal transfers imposed on taxpayers in the core countries are opaque enough and expected to vanish someday. Hans-Werner heavily doubts it when he writes: "membership of the Eurozone does not include the right to be propped up with transfers from abroad when a country loses its competitiveness. Letting distressed countries remain members of the Eurozone on permanent life support does not really help them".

Time will tell whether this obituary was a prophecy or the sign of excess pessimism. Recent political developments in Greece and Spain, however, suggest that Hans-Werner is likely to be right.