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Eurozone

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Another Simplistic View from Germany on the Monetary and Economic Crises in Europe – Simultaneously Some Remarks on Thilo Sarrazin's Book "Europe does not need the Euro"[1]

[1] Only available in German with the original title „Europa braucht den Euro nicht", Munich (DVA) 2012,

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The crisis of the European currency and the crisis of the economies of the European countries is not over yet, and it appears that after a number of rescue measures the insight into the ultimate causes of the crises is improving[2].

1. The beginning in 2008

As has been shown before[3], the US subprime crisis has not been the cause of the crises in Europe. The US countermeasures to rescue its financial industry have been adequate to level off the effects of the sudden devaluation of the real estate. There were severe losses of European investors which were left uncompensated. The psychological shock in the US and in Europe and an intensive fear of poverty caused not only a crash in paper investments which –directly and through write-offs indirectly - shook the financial industries, but also a sudden abstinence in consumption; the slump in commercial turnover triggered a standstill of industrial investment and shrinking gross domestic products, which aggravated the problems in the financial sector. In order to break the spiral down-trend and to counter the danger of a complete melt-down of the economies, the financial industries were rescued with fresh money from public entities.

In contrast to European war experiences, this time the physical assets were not damaged, but there was a dramatic decrease of their earning potentials. While unchanged in substance, the assets were no longer producing enough income and lost market-value; it was unclear for how long demand would be slow or absent. Shortly before the crisis, the accounting rules had been amended, obviously by neglecting prior experiences: The new mark-to-market rule caused an increase of book-values and resulting book-profits which turned into nice management boni; this was nice as long as thing went well. Now the exaggerated market reactions materially reduced the book values and created black holes in the balance sheets which translated into loss of book-values, loss of equity, credit problems, and loss of liquidity.

2. Anglo-America

The crises went from Wall Street (Lehmann failure) all over the world like a Tsunami. The epicentre around the North Atlantic had the toughest time. Economies mainly based on the exploitation of resources like e.g. Australia, Canada, and the oil producers were hit less due to the high demand in the BRIC states, Southeast Asia, Turkey and Latin America. Economies based on tourism from the North Atlantic region suffered along with it.

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[2] There is an overwhelming abundance of papers on these issues. I have restricted the apparatus to my previous publications, a few German quotes of outstanding excellence and some helpful links.
[3] Achim-R. Börner, Die globale Finanz- und Konjunkturkrise – die einfache Version, Cologne 20.10.2009, pp. 3, 7-8, available at www.boernerlaw.de, News; see also Thilo Sarrazin, p. 107-109: French growth stalled as early as 2006

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In Anglo-America[4], the crisis was supposed to be ephemeral: When the times get tough, the tough go shopping. All the visible assets were intact and producing as before; with a reduced income from production, physical demand deteriorated as well. The main uncertainty was about the duration of the crisis, and dependant on this, when people, or better: when too many people, would be forced into fire-sales in order to cover their daily needs. This uncertainty was strengthened by a critique of capitalism (e.g. the "Occupy" movement), a new pessimism (e.g. revival of the peak oil theory) and a general distrust in commercial partners and institutions (e.g. Tea Party movement). The main means of rescue were state guarantees, capital infusions by the state (e.g. GM, AIG, Fannie Mae and Freddie Mac), and the infusion of nearly unlimited fresh money by the central banks (directly by providing liquidity for the banking sectors, indirectly by the purchase of public debt; see also the quantitative easements). The sudden drop of market valuation of the assets highlighted the shortness of equity capital; apart from the private pension systems, the savings ration had been low, and there was not enough capital that could be shifted into equity of commercial enterprises

Soon the massive liquidity provided by the Anglo-American central banks will have to be retired without discouraging consumers and entrepreneurs, and all of this before - due to global / external effects - the interest rates go up again. There is a number of central bank measures to achieve this smoothly, if there is no substantial impact of unforeseen sudden effects of global importance.

Sovereign expenditure means that the public entities put money into the private sector. Sovereign debt means that the public entities burrow money and put it additionally into the private sector. This makes sense as long as the private sector, where this money multiplies by circulation, put the additional funds into efficient use and thus can service the debt by taxes. Of course, if the interest rate on the public debt is increased, this means that the private sector has to make more money in order to meet the interest obligation as well as the private yield. If this equilibrium is not achieved, no more money should be funnelled into the private sector, no more public debt should be taken. However, there is also a time factor in this play, as an initial domestic or foreign investment of the funds by the private sector may later turn out to be nicely profitable; then the additional public debt is justified. This risk shows that public debt makes sense only, if the debt service (inclusive of an eventual repayment in case of investment loss) is correctly allocated as a general taxpayers' burden.

Public debt mainly being a liquidity advance on private investments, the US is not over-indebted as long as the private sector earns more than the public debt service and the private yield. And as they take an optimistic view of the future, they can win the world.

[4] This analysis differs from Sarrazin's description, pp. 249 et. seq. So we are also in disagreement on some of the remedies, as proposed along conventional thinking by Sarrazin, pp. 264 et. seq. He does not observe his quote of Herbert Spencer: "The ultimate result of shielding men from the effects of folly, is to fill the world with fools.", see Sarrazin, p. 360

Neither is external debt too much of a problem. It is often said that external debt is a sign of living over one's means and that it is problematic if its proceeds are used to finance non-durable items (consumption, be it e.g. items used in a war or a distribution to consumers via welfare). This is short-sighted at best: The point is whether these moneys are ultimately used in the economy to create additional assets and/or additional profits. It does not matter whether a welfare recipient uses the money for gas in order to go to work or whether a bridge is built or whether the private sector pays less taxes and invests the additional moneys elsewhere. The "foreign" money circulates in the economy and helps to get it going, the interest due on it being only a benchmark to compare the profitability of the alternate use and to justify the alternate deployment of the money. It does not make a difference whether the foreign holder has debentures or currency as long as he can change it into more assets or assets with a competitive advantage like better quality, better security, or better usefulness.

In contrast to most other currencies, the USD is a global currency:

There are global assets covering the currency, and they are traded in USD all over the world. The USD is accepted all over the world in exchange for goods, services, and assets; as long as this general acceptance prevails, there is no room for the fear that the US economy is dominated by foreign creditors.

Moreover, an increasing market value for US assets as well as a renewed profitability of US-held assets will marginalize the importance of external debt; the parallel efforts to repatriate profits, viz. taxes, and to curb imports (e.g. by shale oil and shale gas) will also help.

3. The Euro-zone

The situation is much more complicated in the Euro-zone. There is a more or less perfect common, internal market for 27 EU member states with a common currency in now 17 of them. The single currency in Europe is an aim of the Treaty of Lisbon, which is currently the basis for the EU.

a) The setting

The single currency was created in the Treaty of Maastricht in order to break or at least hide the trend-setting effect ("dictation") of the German central bank, Deutsche Bundesbank, for the monetary policy of the neighbouring countries. The introduction of the Euro was a *quid pro quo* for the neighbours' consent, especially the French consent, to German reunification[5]. In turn, Germany negotiated that the European Central Bank should work in continuity of the rules and policy of Deutsche Bundesbank, especially by being focussed on the maintenance of price stability(Art. 127 I TEUF)[6] and barred from any subscription of public debt (Art. 123 TEUF)[7], and that a member state should not be liable for the public debt of another member state ("No bail out", Art. 125 TEUF)[8]. This tight setting is accompanied by an obligation of the member states to avoid an excessive public deficit[9], this being an imperfect obligation put under the supervision of the EU Commission and the Council (Art. 126 TEUF). The difficult procedures to state a violation and the room for arbitrary decisions have been tested in 2003, when Germany took to an interim deficit spending; this case has demonstrated the flexibility and weakness of the system[10]. The new crisis has triggered a modification of the definitions of the thresholds, the procedures in case of their violation, and the sanctions[11], while still relying on the GDP ratios[12].

When the introduction of the single currency was agreed, your author predicted that due to productivity differences the main purchasing power would be concentrated in the center of Europe, viz. in the EU founder states of 1958, which form a circle around Germany, and that, due to the low productivity and income in the periphery as well as the volatility of its foreign earnings (mostly from tourism), the assets in the center which produce a rather stable income, would command higher and higher prices by having increasing P/E multiples; the latter has been called the Swiss phenomenon.[13]

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[5] Sarrazin, p. 69 sees this differently. He is correct that there was no formal nexus, but sometimes informal agreements are even more binding than formal ones.
[6] Sarrazin, pp. 72-73
[7] Sarrazin, pp. 74-76
[8] Martin Seidel, Die "No-Bail-Out"-Klausel des Art. 125 AEUV als Beistandsverbot, Europ. Zeitschrift für Wirtschaftsrecht (EuZW, Munich) 2011, pp. 529-530; Sarrazin, pp. 95-96; Heike Goebges / Maik Grabau, Money for Nothing and the Risks for Free?, WiSo-Diskurs, Bonn (Friedrich Ebert Stiftung) May 2013, p. 27, read the article in a restrictive way so that it prohibits only the straight assumption of debt and not the assumption of risk by guarantee, but this contravenes the aims and the spirit of the prohibition.
[9] Thresholds are: annually no more than 3 % and accumulated no more than 60 % of the GDP. For the development of the legal scheme see Börner, "Sixpack", pp. 3-4895
[10] For more details see Albrecht Weber, Die Reform der Wirtschafts- und Währungsunion in der Finanzkrise, Europ. Zeitschrift für Wirtschaftsrecht (EuZW, Munich) 2011, 935 et seq.
[11] Sarrazin, loc. cit., pp. 220—224, 355-356
[12] for critical remarks see Achim-R. Börner, Europa und der Euro in der Rettung durch den "Sixpack"?, Cologne 20.11.2011, available at www.boernerlaw.de, Aktuelles and see below at 3.d.
[13] Achim-R. Börner, Die neue Entwicklung des EG-Vertrages: Neue Parameter für den Euro?, Deutsche Zeitschrift für Wirtschaftsrecht 1998, 251, 259

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The possibility was not foreseen that the peripheral states found ways to increase their spending power by increasing their sovereign and external debt beyond their potential to generate income or, respectively, to carry debt. Two circumstances were helpful, the relatively long period of low interest and the rising values of real estate; both circumstances were the effect of bountiful amounts of money, which were seeking investment for any kind of return, even a speculative return. In consequence, the GDP has increased by faster circulation from hand to hand, rather than by more and better production of goods and services or by higher prices for consumer goods. Only the latter point is observed by the ECB due to its task to provide for price stability, and this only on an average. The ECB is concerned with overall price stability in the Euro-zone,

which means that country differences with levelling effects might go into extremes[14]. While inflation in the center of Europe was low, it increased in the periphery; this has meant for the periphery: The higher income corresponding to an increased circulation on the one hand and the prevailing low ECB interest rate made it easy to speculate in real estate and created bubbles[15]. Asset bubbles are not caught by the price indices as long as they do not translate into higher asset lending prices ending up at the consumer level[16].

The GDP increases of the periphery have been misinterpreted by lenders to say that the economy is going well and that the states can service more debt.

As state debt is transformed into private spending power, and this is increased by the handing out of credit by the banks in view of income improvements from accelerated turnover, more and more money is in circulation. Part of it is for the payment for imports and ends up circulating normally in the center of Europe. But another part of it goes into in local asset bubbles; they have a broad effect but a slow turnover: These moneys boost the balance sheets but circulate less and disguise the inflationary trend.

It is obvious that such an overvaluation of claims and assets in parts of the currency area weakens the currency, albeit in a diluted way: Due to the large area of the currency union and its numerous assets, the effect is watered all over the currency zone. Where there are no bubbles, the assets are comparatively undervalued; those assets and their products can now be bought with a weaker currency.

Furthermore, in order to stay competitive in the world markets, especially German workers have withheld their claims for wage increases, and Germany did everything to bring down product unit cost: constant investment in producing assets, production and product innovations, streamlining of state and private procedures of every kind.

[14] Joebges / Grabau, p. 8-9
[15] Joebges / Grabau, pp. 12-13; see also Sarrazin, pp.274-276
[16] Joebges / Grabau, p. 8

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In consequence, the center of Europe gave away its products cheaply, if you so want, like some sort of reparation for war damages. Workers in the European center received less monetary value than the much less productive workers elsewhere, and they received a currency which could by more in their neighbourhood than in the periphery.

This translates into a cheap outflow of goods and services into the peripheral countries whose capability to compete - or better: whose capability to earn - was shrinking and who had not any longer the chance to enhance demand for their products by currency devaluation. The reduced income in the center of Europe[17] resulted in the - accidental - eradication of competitors and suppliers in the periphery. It remains to be seen in how far this policy with its imbalanced burdening is advantageous in the medium und long term.

b) The phantoms have burst

In 2008, the US subprime crisis has demonstrated that asset bubbles may burst at some point in time. People seek security in cash. The circulation of money slows down. Asset prices and others dwindle. Credits are called. The economy implodes.

In order to break the vicious circle, the banks need fresh money. In the center of Europe, the creation of values and the taxes were high, and state expenditures were moderate. So the states came forward with capital infusions and guarantees for their banks and could easily refinance this. In peripheral Europe, the creation of values was low, taxes were collected irregularly, and state expenditures were high[18]. In view of a diminishing value of the asset base, lenders were dragging their feet and even sought to reduce their exposures. Party time in the periphery came to a stop. It was feared that the lenders' reluctance might spread to the center of Europe ("contagion").

The members of the Euro-zone, and that means its solvent members of the European center, had either to step in and rescue the financial systems and states in the periphery or to step out and let some systems and states collapse[19].

[17] So it is not surprise that despite of a similar economic structure the Swiss GDP and PPP have exceeded the German figures for that period; for the figures and their analysis see Sarrazin, loc. cit., pp. 108 et seq.
[18] for country analyses see Sarrazin, pp. 328-350, though his description is without regard to the shadow economies.
[19] For legal consequences of the exit of states from the Euro-zone see Peter Kindler, Währungsumstellung, Vertragskontinuität und Vertragsgestaltung, Neue Jurist. Wochenschrift (NJW, Munich) 2012, 1617 et seq.

c) Stepping in

There is an adamant discussion whether stepping in[20] is less costly than stepping out (by leaving the common currency or by making the periphery leave it)[21].

The traditional reasons for maintaining the Euro as a single currency are that there are advantages for competition and consumers and that lenders and traders would not be able to distinguish between the European countries. These reasons may help to sell a step-in decision to the general public, but they do not hold in today's real world of easily available apps and boni-gilted trader whiz-kids[22]. The main argument is – as Sarrazin aptly shows - that economic integration in the center of Europe has been so intense that it would not make sense to take currency decisions along the member state borders; e.g. France and Italy would have to be divided into a northern zone (hard Euro) and a southern zone (Club-Med or Med-Euro)[23]. Having them in or out or partially in and partially out, is not politically feasible nowadays, and in the medium term splitting up these nations into different currency zones and different zones of attraction for investment could severely disrupt the internal market.

Stepping in might set a precedent and lower the moral hazard of weak nations and their institutions[24], but also gives a clear sign that the path of integration is followed as agreed in the Treaty. The correct way of stepping in is that each state will refinance its ailing financial sector and that the Euro zone members help to finance the sovereign debt. Thus, the debt is carried by the nation, and at least in the longer term it is secured by all national assets; the state may and should burden his natural and moral persons as well as all assets in its territory so that repayment schedules can be met. It is not just and cannot be explained to taxpayers of a helper-state to leave the chance to the debtor-state to ask for debt relief while its citizens retain their properties free from encumbrance[25].

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[20] For the various instruments (ESFS, ESM, Eurobonds), conditionalities (Fiscal Agreement, Banking Supervision) and organs (EU, Council, ECB, member states) involved in the rescue operations see Jörg Gundel, Die europarechtlichen Instrumente zur Überwindung der Finanzkrise, Greifswalder Halbjahreswschrift für Rechtswissenschaft (GreifRecht, Greifswald) no 14 (2012), pp. 69 et seq.; Peter-Christian Müller-Graff, Euroraum-Bugethilfenpoliitk im rechtlichen Neuland, integration (Berlin) 2011, 289 et. seq.; see also Christoph Hermann, Die Bewältigung der Euro-Staatsschulden-Krise an den Grenzen des deutschen und europäische Währungsverfassungsrechts, Europ. Zeitschr. Wirtschaftsrecht (EuZW, Munich) 2012, pp. 805 et seq.; for Eurobond issues see Franz Meyer /Christian Heidfeld, Verfassungs- und europarechtliche Aspeckte der Einführung von Eurobonds, Neue Juristische Wochenschrift (NJW, Munich) 2012, pp. 422 et seq.

[21] The German exposure and potential cost is fairly well documented, it amounted to ca. 770 bn EUR in mid-2012, see Sarrazin, pp. 216

[22] see also Sarrazin, pp. 244-246

[23] Sarrazin, pp. 387, 400, 408

[24] Sarrazin, p. 294, 360

[25] Sarrazin, hints at this route on p. 368, but then (p. 285) he overlooks this potential attachment to assets and restricts his arguments to the savings ratio.

If, however, the helper-nations or the ECB assume the state's task to refinance its financial sector, there would be no recourse on the citizens of and the assets in the distressed state. Furthermore, the taxpayers of the helper-nations would also have to make up (without recourse) for commercial misjudgements of the refinancing of foreign banks which have eventually been unrelated to the Euro crisis.[26]

So it makes sense to hand out relief credit to the next broad shoulders rather than to some tiny foreign entity where the chances are greater that in the end the credit claim will be lost. Even if - as planned[27] - the ECB starts to supervise the financial institutions of systemic relevance[28], it should not assume the primary responsibility for their rescue and thus make individual commercial risks a risk of all the member states holding stakes in the ECB[29]. This is particularly evident when a commercial bank, acting with encouragement from and for the benefit of its home state, engages in risky non-EU foreign activities or starts a shaky lending for domestic purposes; it is better that in the first place the national tax-payer pays for such losses than that the loss is diluted to all the tax-payers of the Euro-zone.

Stepping in by the member states (directly or indirectly via their common institutions) occurs only, when the market for capital unwilling to lend at all or is willing only at unsustainable interest rates. Normally, the interest rate shows when the limits for lending are approached; raising interest rates for sovereign lending are the most accurate warning sign that things start to get complicated. If the state does not react to the warning, it cannot lie with the helper-states to supply funds. However, this is not the situation of the current Euro crisis. Here, the market had suddenly realized its over-exposure, which was ultimately due to a GDP that was shrinking because of a global crisis; e.g. tourists from industrial states stayed away from Greece like from other, competing Mediterranean countries, diminishing its GDP, worsening the GDP-debt-ratio, triggering default clauses and casting doubts on the potential for servicing new – and old – sovereign debt. Joseph Stieglitz[30] has correctly pointed out: "Remember, the recession caused the deficit, not the other way round."

Moreover, the need of the financial system for rescue money was created by the sudden loss of market value of assets in the aftermath of the US subprime crisis. This double hit was not directly self-inflicted, and the rescue measures come close to Art. 122 para 2 TEUF (help in catastrophic situations).

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[26] The situation in the Greek state of Cyprus is different, as those banks accepted mainly foreign (Eastern European) funds, often of a dubious nature and regularly not invested in Cyprus (and Greek) state debt; for the repayment of those funds, an enslavement of the national citizenry and economy for years to come would have been overly burdensome. Beyond that, the stakes in Cyprus were too small to make the rescue a mistake.

[27] EU Commission, Communication – Road map for a banking union, KOM (2012) 510 of Sept. 12, 2012

[28] Council of the European Union, Press Release: Bank Supervision, Doc. 8001/13, Press 136, Brussels 18.04.2013, available at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/136846.pdf

[29] DB Research, EU Banking union, Frankfurt 23.07.2012, available at http://www.dbresearch.de/PROD/DBR_INTERNET_EN-PROD/PROD0000000000291512/EU+Banking+Union%3A+Do+it+right,+not+hastily!.pdf

[30] Joseph Stieglitz, The financial crisis, IBA Global Insight (London) Dec. 2012/Jan. 20123, pp. 22 et seq.

d) Sovereign debt

However, the high indebtedness incurred before 2008 had also contributed to the financial distress and the inability to cope with the crisis situation. The peripheral states had neglected the German proverb: Save in time, so you have in times of need. Light-hearted fiscal spending, promoted by a short-sighted and greedy electorate, was enabled by cheap refinancing and the mirage of consistently raising asset and real estate prices. It was careless to neglect the potential for a rise of interest rates which apart from its immediate effect on debt service, also would curb demand for assets and real estate. This is why the first rescue operations (of EFSF and later of ESM)[31] required deep cuts in fiscal spending and why later the "six-pack" legislation of the EU[32] as well as the European Fiscal Compact[33] has obliged the states to legislate for a "fiscal brake", viz. to observe a debt threshold which is defined as a percentage of the GDP[34]. This was basically a good idea, although there are some obstacles[35]:

(1) The GDP is quite volatile, unless you have a very diversified national economy with a large national market; just think of the rapid changes of trends in tourism, which have hit the Mediterranean countries, and of trends in the financial business, which have hit Ireland, the UK, and (non-EU) Iceland. You cannot expect a change e.g. of the pension schemes and of public servant salaries along with yearly tourist numbers. There are budget positions which are less flexible, and others which are more flexible. Especially in view of social stability and environmental protection, it may make sense to run into a deficit in order to avoid material damages to the state or its economy. It should be a desperate measure of last resort to have all the budget positions take a haircut in view of a volatile GDP.

(2) A fixed limit for the relation of state debt and GDP does not take into account that each national parliament has the right to decide whether to follow the Keynesian model and whether to invest for an economic turn-around, be it on a debt-basis, be it on a tax-income-basis. However, the national parliament has to decide whether the moneys created from public debt will earn enough surplus to service the debt. Taxpayers may invest domestically or abroad, but if they do their jobs inefficiently, e.g. by investing in inflated values (bubbles), it is time for austerity and to make them take loans on their private assets.

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[31] For the technical aspects see Philip R. Wood, How the Greek Debt Reorganisation of 2012 Changed the Rules of Sovereign Insolvency, Bus. Law Int. (London) 2013, pp. 3 et seq.
[32] for an overview see EU Commission, Release: A short guide to the new EU fiscal governance, Brussels 14.03.2012, available at http://ec.europa.eu/economy_finance/articles/governance/2012-03-14_six_pack_en.htm
[33] Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, of March 2, 2012, available at www.consilium.europe.eu/documents
[34] For the development see EU Commission, Communication – Common principles on national fiscal correction mechanisms, COM (2012) 342, Brussels 20.06.2012
[35] Börner, "Sixpack", pp. 20 et seq.; also critical Sarrazin, p. 354-356; for the more technical shortcomings see Friedrich Heinemann, Marc-Daniel Moessinger, Steffen Osterloh, Feigenblatt oder fiskalische Zeitenwende? Zur potenziellen Wirksamkeit des Fiskalvertrages, integration (Berlin) 2012, pp.167 et seq.

(3) Finally, the sovereign debt may be financed primarily nationally (as e.g. in Belgium); then a higher debt-ratio does not necessarily lead into a volatile refinancing position.

The legislation and the Agreement provide for the assessment of a given situation by the member states and thus give some leeway for good reasons. The helper-states fear that in view of a majority of over-indebted states such decisions may be taken in view of future own distress situations rather than on an economically well-reasoned basis; in such case, a gang of indebted states may try to live on the savings of the electorate of the conservatively financed states. A solution to this problem may be to involve a neutral institution like EBRD in the decision-making, preferably with a decisive vote; this would amount to a good practice, as for similar reasons the IMF has been involved in the rescue packages for Greece.

There are a number of more technical items in this legislation and the Agreement which may render these tools less efficient; e.g. state guarantees are not included in the indebtedness as long as they are not called upon; pension schemes are a special long-term problem; the line between private and public enterprises differs from state to state and in a given state even from time to time, and this must be accounted for; the same is true for subsidies, which may come in various kinds.

The problem of sovereign debt is widened by the working of the so-called target accounts at the ECB. Each national bank of a Euro member state holds such an account for the clearing of the export-import-balance. If an importer has to pay an exporter, the importer orders his bank to make a payment to the exporter's bank. This means that the importer's bank draws on a line with his national bank and that his national bank effectuates the payment from its ECB target account to the ECB target bank account of the exporter's national bank; this latter national bank brings the money into the account of the exporter's bank. The accounts of the national banks at the ECB are operated as clearing accounts; if there are no sufficient funds, the transaction is still carried out, without securities requested. Thus, each national bank can draw unsecured loans in order to fulfil international payment claims. The national banks of the periphery have drawn heavily on these target accounts, which is a problem, since their shareholder states have trouble to raise money due to the sovereign debt crisis. In effect, the ECB is providing substantial loans to the states of the periphery[36], while keeps them from insolvency. This liquidity goes into the system in the exporter nations, where the exporters earn their money and are relieved from the risk of non-payment. The ECB assumes the risk of non-payment by the importer state. This risk is increasing as the private banks are allowed to refinance at their national banks by lodging less valuable securities for credit.[37]

[36] The name "target account" carries the acronym TAB for Target Account Balance, which is what the ECB and its shareholders will have to pick up pro-rata, if a national central bank – or ultimately its national state - cannot pay up. For more details see Hans-Werner Sinn, Die Target-Falle, Munich (Hanser) 2012; Sarrazin, pp. 128-135

[37] Joebges / Grabau, pp. 35-36, 21 et seq.

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This adds up to the ECB exposure for non-performance on sovereign debt acquired on the secondary market. In contrast to normal national banks administering a national currency, the ECB has a risk of sovereign non-performance in its balance sheet.[38]

This is a different aspect than the liquidity which to manage is a main ECB task. Presently, the ECB is defending the periphery states against insolvency by illiquidity and takes the disadvantage of creating more money on a constant asset base. This may end in inflation or stagflation, unless the money is and remains retired from immediate circulation in M3. This policy does not help against insolvency by over-indebtedness. However, this may be solved by a debt-release. Hopefully, this can be structured to reduce M3[39] without loss of value of the assets of private investors. Nevertheless, any such write-off has to be paid by someone else than the debtor state and its tax-payers.[40]

e) The internal market

Very important issues arise from the Lisbon Declaration[41] and the follow-up strategy paper "Europe 2020"[42] to implement coherent principles of economic policy throughout the internal market. All these strategies are grand and hard to make operational. They may be prone to overdo on the obligation under Art. 3 para 3 subpara 1 of the EU Treaty, to encourage a sustainable development of a highly competitive social market economy on the basis of a balanced economic growth and price stability. This is a quality aim and is not comparable to the obligation under the German constitution to strive for similar conditions of life over all the territory. The misunderstanding in the EU mainly affects the results of the trade and payment statistics. It is not compatible with the internal market to observe and to level out the trade and payment figures between the member states. There are industry-specific production centers, service centers, and financial centers, and it does not make sense to balance the effects of such historic or chance geographic positioning.[43]

The over-indebted countries put forward that their deficits have accrued because of imports of goods and services from the center of Europe, that it was a fault of those countries to offer them so much, and that they have benefited from this additional demand. It is true that the sovereign debt means more money in the hands of the citizens, but this does not allow the conclusion that only, but fully such additional money was used for imports. Even if on a lower pension, the pensioner may choose

[38] Sarrazin, pp. 226-233; clearer Joebges / Grabau, p. 44, see also pp. 29, 32-34
[39] For the monetary policy means for a reduction of excess liquidity see Joebges / Grabau, p. 43
[40] see Joebes / Grabau, pp. 32-34
[41] Lisbon Summit European Council Resolution of March 23-24, 2000, available at http://www.europarl.europa.eu/summits/lis1_en.htm
[42] Conclusions of the European Council of June 17, 2010, available at http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ec/115346.pdf; for further details see http://ec.europa.eu/europe2020/index_en.htm
[43] Börner, "Sixpack", p. 24

to neglect the domestic cappuccino and to save for an imported automobile. You might only try to extrapolate the figures on a pro rata basis, e.g. the excess GDP percentage of sovereign debt may have increased imports at the same ratio. Imports are from foreign private entities, and one can assume that the additional turnover has contributed to the tax-income of their home states. The benefit for the helper-state will be a percentage of a percentage, and this will not suffice to make liable for rescue money.

The over-indebted countries say that at their expense the helper-states gain from interest-carrying rescue funds. This neglects that capital is scarce and carries a price for everybody. Normally the helper-state also has to turn to the capital market to raise the rescue funds quickly and then has to pay interest. The spread for the over-indebted country should cover the risk of breach of debt-service and must be agreed at market rates in order to avoid the reproach of bad housekeeping and neglecting the interest of the domestic tax-payers who ultimately bear the risk.

f) The way out

The over-indebted countries complain that the austerity imposed on them by credit constricttions stresses their social fabric and leads to an economic melt-down[44]. This has two aspects:

(1) Good governance comes at a price and is non-negotiable. Usually it creates jobs for the higher qualified officials and cuts jobs for paper-pushers. In consequence, the system achieves more justice. This can be seen e.g. in Greece where in general the employees paid their taxes and the self-employed did not.

(2) A population spoilt with money from fresh debt must learn that it cannot live over its means and that promises on such a basis cannot be kept. It is too bad that the politicians who have lead into the quagmire are not held personally responsible and that the new politicians are faced with the uncomfortable consequences of previous misconduct.

(3) The economic melt-down is not a consequence of the infusion of rescue money. It would be a consequence of a liquidity shortage, but the ECB has seen to it that this does not happen[45].

[44] Stieglitz, p. 25 points out: „One should remember austerity has almost never worked. This is an idea that's been tried over and over again."
[45] Börner, Finanz- und Konjunkturkrise, p. 13; with good reason pointing at the lack of conditions when the ECB furnishes liquidity to the commercial banks, Joebges / Grabau, p. 44, 29 et seq.

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Rather, it is especially a consequence of long-term, broad lack of entrepreneurial ideas and spirit. Too many people stick to their reduced means and do not endeavour new ventures, as going abroad and making remittances, or investing into new domestic ventures and creating new jobs, e.g. by making capital investments for a cheaper production of goods and services; improving tourist services; creating hubs for commerce with Southeastern Europe, Turkey and the Near East[46]; and/or attracting retirees for new special settlements, facilities, and nurseries. The development and implementation of new ideas takes time, and the improvement of tax income as well as the service on rescue moneys is depending on the success of the new ventures. You can easily imagine that the wish of the helper-states to limit their exposure is in conflict with the necessity to restructure a failed economy; this ends in the platitude that it is difficult to balance greed and fear. So what are the achievements of the over-indebted states to alleviate the fear of the helper-states and their electorates?

This is carrying us from simple monetary policy and immediate rescue measures to the long-term prospects to overcome the crises. Some are painting a transfer union and/or joint debt instruments. In both cases, the good rating of the center of Europe is transferred to the periphery, either by regular payments state-to-state, which are easy to condition or to stall, or by a permanent levelling of interest rates to the benefit of the weak and the detriment of the strong. In both cases, the taxpayers of the helper-nations have the fun to finance the well-being of closer or remoter neighbours and the risk to be stuck with repayment obligations[47]. Obviously, both cases embody a principal-agent problem with a view to the EU and Euro institutions and their majorities on the one hand and the risk-takers on the other hand; both solutions cannot be sold to the electorate of the helper-nations.

In consequence, the present way for ad-hoc rescue moneys is nearly exhausted, and new commitments for a sizeable long-term financing to be provided outside existing institutional channels have only a remote chance. This is why an important number of economists say that the rescue measures have only burrowed limited time[48] and that in the long run the differences in competitiveness will necessitate to give up the single currency and to allow for exchange rate adjustments between the currencies of the states or higher entities of near-uniform competitiveness[49]. While their first finding is correct, their second conclusion seems to rely on a view of a stable historical situation of the national economies and to neglect the chances for change, so that their pleadings help only for a last way out.

[46] for neighbourhood coordination see Börner, „Sixpack“, p. 27
[47] for more details see Sarrazin, pp. 360-369
[48] Joebges / Grabau, p. 45
[49] Most economists would regret this development, but see hardly an alternative. See e.g. Sarrazin, p. 417; Sinn and various political movements in the helper-nations.

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As for these chances, it is a stupid way to think that now Cyprus and Greece should manufacture cars or machinery, while the traditional firms offer existing products in a worldwide competition to a reluctant market. It is a stupid way to think that the over-indebted states of the Mediterranean should copy the industries of the center of Europe and might be successful in doing so. This has not even worked in Eastern Germany, despite a similar culture and heritage.

Rather the problem areas should rely on their specific strengths and develop from there. A look at the German Ruhr Area shows that a region traditionally governed by the montane industry (coal and steel) has transformed into a modern, highly diversified industrial region with edge-technology and the latest in services. This has not been imposed by some sort of general planning process but by developing existing skills, attracting new ideas through market incentives, and making entrepreneurial investments for the cheaper production of new and better goods and services. So it can be done, and it should be done.

This is a long shot, which requires a number of interim steps. E.g. inviting people to look for work abroad so that remittances help to alleviate the dire present situation of the periphal states. E.g. preparing the public entities to speed up and simplify their procedures to facilitate new ventures. E.g. preparing the future entrepreneurs and employees for their new task, mainly with a specific dual education (learning in theory and in industrial practice) and with incentives for a hands-on approach.

The EBRD is an adequate tool to help along, and it should be strengthened according to this gigantic task. The other institutions and all member states must do their best to help with experience and efforts. Time is pressing.

All politicians and the general public in Europe should take a longer view and a larger attitude on these issues. Problems which have accrued over decades cannot be solved in the time of batting an eyelash. To get out of this mess, it takes time, patience, tremendous effort much beyond the usual European phraseology, and much more strategic (rather than tactical) thinking than has been dedicated up to now. But it can be done, and the Euro may continue.