Bogenberg Declaration: Sixteen Theses on the Situation of the European Monetary Union

In a joint strategy meeting held on 15 October 2011, the trustees of the Friends of the Ifo Institute and the Ifo Executive Board discussed the situation currently affecting the European Monetary Union. Out of deep concern for Germany and Europe, the signatories decided to publish the following declaration, which sums up the results of the discussion.

Summary

1. The euro itself was a leading cause of this crisis by ushering in a remarkably swift convergence in interest rates, which had the effect of directing too much capital into countries that formerly had had to pay high interest rates. This undermined the competitiveness of these countries through inflation and gave rise to huge deficits in their current accounts.

2. Germany has by no means been the euro winner; on the contrary, following the introduction of the euro it lagged behind nearly all other Eurozone countries in terms of economic growth, investment and employment.

3. The euro is not suffering from a mere confidence crisis that can be resolved by assuaging the markets; it is experiencing a profound balance-of-payment crisis that is being prolonged by the expansion of public financial aid.

4. Since autumn 2007, long before the official bail-out initiatives began, some of the crisis-hit countries have replaced dwindling private capital imports and capital flight with their money-printing presses (Target credits).

5. Export surpluses create no real value if they translate into claims vis-à-vis countries which ultimately cannot pay their debts, especially not if, as in the case of the German export surplus with regard to the other euro countries, these claims are mere compensating claims held by the Bundesbank vis-à-vis the ECB (Target claims).

6. The ECB Council overstepped its mandate when it transferred to Eurozone national central banks, primarily the Bundesbank, the task of financing the public and private deficits of other countries.

7. Germany's liability for the bail-out initiatives does not total 211 billion euros, as often cited, but is actually now close to 600 billion euros if the far larger bailout initiatives of the ECB are included in this figure.

8. The Target credits and the purchase of government bonds by the ECB system transfer the investment risk of private investors and banks to the taxpayers of economically sound countries, posing a threat to the euro because they offer debtor countries incentives to advocate inflationary policies at the ECB Council which would help them defer their obligation to repay their foreign debts.

9. Eurobonds would undermine debt discipline, lead to much higher interest burdens for the German state, and anew induce capital flows in Europe that would exacerbate the external imbalances.

10. Only a restrictive rescue policy that keeps rescue funds short will give the over-indebted countries incentives to reduce government spending and improve their competitiveness through price and wage restraint.

11. Since the crisis-hit countries comprise 40% of the Eurozone population, if Germany consents to a European transfer union it would overextend itself financially and impose substantial welfare losses on its citizens.

12. A currency area does not need guarantees that protect against insolvency, but creditor liability and interest spreads that reflect the different creditworthiness of borrowers, because otherwise the deficit countries tend to import too much capital, which results in excessive external economic imbalances.

13. A policy geared to turning Germany into the creditor of southern European countries will sow discord.

14. The task of German policy is not to assuage the capital markets but its own citizens, because the former will apparently be reassured only when the latter are willing to buy up the toxic government bonds of the Eurozone's peripheral countries from institutional investors.

15. The Eurozone does not need an economic government that decides directly or indirectly on the flow of credit to the over-indebted countries, and thus converts the intended debt brakes into rights to credit. What it needs is to limit the flow of public credit from the creditor countries.

16. If Germany is deemed to be too cheap and its current account surplus too high, it is necessary to let the credit-driven boom taking place in Germany after the crisis run its course instead of risk destroying it by forcing out, with public assistance, the capital that is now reluctant to leave Germany, or even to ruin Germany as an investment location through EU-mandated domestic wage increases.

Germany should make the rules listed below a condition for its support to a re-drafting of the EU Treaty.

a) The ECB's activities must be restricted purely to monetary policy.
b) The allocation of voting rights and the decision-making rules in the ECB Council must be revised.
c) Target debts are to be settled on an annual basis with interest-bearing, marketable assets as in the USA.
d) The rescue package is to be complemented by a clearly defined crisis-solving mechanism and an insolvency statute defining and limiting the timeframe of the bailout measures adopted by the community of states.
e) In the case of a crisis the community of states will focus on support that improves governance and competitiveness, and will provide a financially stricken country with no community funds beyond emergency liquidity assistance.
f) In the mid-term, provision should be made for banks to hold capital for government bonds and accept the state as a co-owner in emergencies if they cannot recapitalise using their own resources.
g) Countries that are not competitive enough to repay their foreign debts should, in their own interest, leave the Monetary Union.

1. Causes of the crisis

European Monetary Union is experiencing a deep structural crisis caused by the excessive private and public indebtedness of the peripheral countries. The fact that it has come to this level of debt is due to the euro itself. The announcement of the euro and its introduction reduced interest rates in southern countries to the level of those in Germany, not least because flawed regulation created false expectations of lower investment risks. The lower interest rates induced public and private agents to indulge in excessive borrowing in the countries that would eventually trigger the crisis. This unleashed an artificial, credit-financed economic boom that pushed up prices and wages much faster than in other Eurozone countries, increasing imports and curbing exports. An economic bubble formed, which in some countries pushed prices and wages far above their long-term equilibrium level. The bubble burst when the capital markets refused to continue to finance the massive current account deficits that had built up as a result. Today, with their inordinately high prices and wages, those formerly booming countries are undergoing a deep structural crisis and are no longer competitive. What they need now is a realignment of their exchange rates, as is sometimes undertaken in a fixed exchange rate system, to make them cheaper, but this path is not available in a monetary union. The only remaining option is to reduce wages and prices compared to competitors, or to continuously request support from other countries.

2. Germany: The euro winner?

Germany was not the euro winner, as some politicians argue, but is benefiting from free trade. The massive flow of capital out of Germany and into the deficit countries ushered in by the introduction of the euro is a major reason why Germany had the lowest net investment rate of all OECD countries for a long time, lagged behind them in terms of growth and was hit by mass unemployment, which forced the Schröder government into implementing painful social reforms. From the start of interest rate convergence, triggered by the announcement of the introduction of the euro as early as 1995, until 2007, the last year before the crisis, Germany had fallen from third to eleventh place in the ranking of EU countries by GDP per capita. In the light of these facts, the assertion that Germany has profited in any special way from the euro is untenable.

Germany was not able to achieve above-average growth until after the outbreak of the euro crisis in 2010 and 2011. However, that was partly because it had already survived its own euro crisis through years of restraint in terms of wages and prices accompanied by strenuous efforts on the part of businesses, and partly due to a revised assessment of foreign risks, which induced German investors to keep their money in their relatively safe home port. The economic recovery of the last two years was indeed primarily driven by investment. They enabled Germany to work its way up from eleventh to ninth place in the ranking of EU countries. So the current success is not achieved thanks to the euro, but actually despite it, and because of its crisis.

3. Just a confidence crisis?

The euro crisis does not merely represent a crisis in confidence, rooted in dysfunctional markets, as repeatedly asserted by debtors and their creditors in order to open the pockets of their rescuers; it is a classic balance-of-payments crisis resulting from excessively high prices for goods and assets in the deficit countries. In this sense the attempt to contain the crisis by increasing the firepower of bail-out systems is doomed to failure. In reality, this will reinforce the lack of competitiveness of the peripheral countries, for as long as public funds are available to finance current account deficits, the requisite correction of excessive wages and prices will not happen. Moreover, this will fuel capital flight since it will create a one-sided downward risk for assets like real-estate, companies and securities. Everyone knows that their value will decrease as soon as the rescuers' pockets are empty. That is why rich asset owners in the crisis-hit countries, who have already salted away their assets to safety, continue to prefer to buy German firms, real-estate and government bonds than to face the risk of incurring capital losses in their home countries. If this goes on, it will lead to the rescuers' pockets indeed emptying out without actually addressing the structural causes of the crisis, which could ultimately provoke a collapse of the system.

4. Unsanctioned self-help via the printing press

Many believe that the euro area is suffering from a temporary crisis that did not necessitate bail-out initiatives until last year. This belief is wrong. As early as autumn 2007 the crisis-hit countries started financing themselves massively with the money-printing press, which, by way of reallocating the refinancing loans of the central bank system, led to a public capital export from Germany to the crisis countries, replacing the dwindling private capital flows and the money departing because of capital flight.[1]

The Bundesbank has by now amassed almost 500 billion euros in compensating claims (Target claims), which earn little interest and cannot be called due. If the euro area had adopted the rules of the US monetary system, the Bundesbank would have received marketable securities from the crisis-hit countries instead of mere compensation claims against the ECB. This would have significantly stemmed the tendency to resort to the money-printing press.

Aggregated over the period 2008-2010, the current account deficits of Greece and Portugal were financed practically in their entirety by the money-printing press. Only recently the printing press slowed down as the community of states finally came to the rescue with public bailout initiatives. The euro area is currently entering the fifth year of what effectively amounts to a full rescue of Greece, and to a large extent of Portugal as well. In the case of Spain, a significant share of the current account deficit has been financed with the printing press. Ireland printed a lot of fresh money to compensate for capital flight. Like the USA under the Bretton-Woods system in its day, the crisis-hit countries are effectively playing the role of reserve-currency countries, and have covered their financing deficits vis-à-vis other countries with money that they have printed themselves instead of with private loans and money inflows from other countries taken at market conditions.

---

[1] We use the term “money-printing press” here as a metaphor only, as the international money flows booked through the Target system are, of course, not to be interpreted as physical flows. Also, terms like “money shredding”, “overheating of the printing press” and so on are mere metaphors to provide a reasonable heuristic for complicated booking phenomena. For details see, H.-W. Sinn and T. Wollmershäuser, “Target Loans, Current Account Balances and Capital Flows: The ECB’s Rescue Facility,” CESifo Working Paper No. 3500, June 2011 (www.cesifo-group.de/DocDL/cesifo1_wp3500.pdf), NBER Working Paper No. 17626, November 2011 (www.nber.org/papers/w17626).

The ECB Council not only tolerated this process, but also energetically supported a lowering of the collateral standards for refinancing loans to banks. By waiving even a minimum-quality standard of the Greek, Portuguese and Irish government bonds submitted as collateral, it indirectly encouraged a monetization of the public debt of these countries.

The Bundesbank mopped up the inflowing liquidity through a retrenchment of refinancing credits and by borrowing from German commercial banks. It has meanwhile become a net debtor of the German banking system.

In a further development, massive capital flight from Italy and France to Germany started in the summer of 2011. International banks and insurance companies are withdrawing their loans on a large scale, while at the same time an increasing number of investors from these countries have taken a heightened interest in German assets, real estate in particular. The Italian and French central banks are compensating for the capital flight with freshly printed money, in exchange for which Germany must content itself with Bundesbank Target claims on the ECB. The printing presses in Italy and France are overheating while the inflowing money is shredded at the Bundesbank. No limits to this process have been set to date.

5. Missing proceeds

Resorting to the money-printing press has consequences for the interpretation of the German export surplus. Normally, a country that enjoys an export surplus can acquire titles to assets abroad that earn interest and profits, and that can be sold as needed if the domestic economy should flag. In the Eurozone, unfortunately, this was not so.

In the three years from 2008 to 2010, Germany accumulated a current account surplus of 264 billion euros vis-à-vis other Eurozone countries. But in net terms this did not translate into it acquiring titles to assets abroad, such as factories, real estate or securities. Instead, fully 255 billion euros, or 96% of the entire surplus, was “settled” with Target claims of the Bundesbank on the ECB. The meagre remaining 4% corresponded to other claims, half of which were claims derived from public rescue operations.

The private sector benefited from this inasmuch as it helped to reduce its indebtedness to the commercial banking system and the Bundesbank. Some may consider this sufficient compensation for the trade surplus. But in this process the Bundesbank exchanged domestic claims on the German banking system for foreign claims on the ECB which no one knows how to call due should the euro disintegrate and the ECB be folded. The recapitalisation of the Bundesbank through tax increases that would be necessary in such a case would probably annihilate the entire private wealth increase resulting from the trade surplus in the three years under consideration.

Trade surpluses are, of themselves, no badge of success, as politicians are wont to proclaim. They are only useful if they help it to acquire safe assets yielding market-driven interest that can in turn help to secure the standard of living in times of need, by running up current account deficits. If Germany had to write off all or part of its Target claims on the ECB, its export surplus vis-à-vis the other Eurozone countries would be for nought, mere donations that did not make the country any richer. The Germans would have then worked for nothing.

6. Overstepping the mandate

In 2010 the ECB instructed the Eurozone's national central banks (NSBs) to purchase government bonds of the stricken countries. In the past four months alone, purchases exceeding 130 billion euros have been ordered. Altogether, assets worth more than 200 billion euros had been purchased to the end of November, 27% of which were bought by the Bundesbank.

This was a clear breach of the prohibition to monetise the public debt enshrined in Article 123 of the EU Treaty. The two German representatives to the ECB Council have resigned in protest, and German President Christian Wulff has accused the ECB of circumventing the Maastricht Treaty. The new Bundesbank president, Jens Weidmann, fights a losing battle; just as his predecessor, he is always overruled in the ECB Council. German politicians should not take this sitting down.

The financial help provided by the Bundesbank is essentially of a fiscal, not monetary nature. For one thing, the effects on the money supply, as the ECB itself repeatedly emphasises, are sterilised. For another, these aid operations shift massive amounts of capital, with all the attendant risks, among the countries in the Eurozone. They should have been sanctioned by the corresponding parliaments.

The original mandate of the ECB was to follow the Bundesbank model, not to ram through its policies in opposition to the Bundesbank. It is preposterous that the ECB Council, in which Germany is underrepresented, should claim the right to allow a group of countries to solve their external funding problems by resorting, over long periods, to the money-printing press. What was originally intended as a short term transaction credit cannot be used as a permanent source of funding. Whoever tolerates or, worse, encourages this oversteps his mandate.

Germany is stuck with its Target claims and can no longer leave unscathed the euro even if it wanted to, since if the euro should collapse, there would be around 500 billion euros in outstanding claims on an institution that no longer exists. Thus, thanks to the free access to the money-printing press that the ECB Council has granted to the over-indebted countries, Germany has become open to blackmail.

Therefore, one of the highest priorities for German politicians should be to change the rules governing the actions of the ECB. At the very least, Germany cannot agree to any change in the treaties that envisages an expansion of the rescue operations if no measures are agreed beforehand on limiting the self-service with the money-printing press, by adopting for instance the US rules for settling Target balances with marketable assets.

Should the ECB indeed be authorised to grant credit to the member states, be it through a systematic shifting of refinancing credit among the countries or through the purchase of government bonds, it must have a decision-making system like the one agreed for the bailout operations between countries. Under that system, the voting rights reflect the liability structures present, requiring unanimous approval for landmark decisions.

7. Gigantic liabilities

The liabilities arising from the ECB's risk policy have been incremented since last year by the liability risk resulting from the official rescue packages. Politicians and commentators mention these liabilities without acknowledging that they are only a fraction of what Germany would really have to shoulder in a worst-case scenario. If the Bundesbank's share in the liabilities and the financial aid already granted are also included, Germany's liabilities are not just 211 billion euros, but rather closer to 600 billion euros, with a daily upward trend. Germany's peerless creditworthiness in the international capital market is in serious jeopardy.

Politicians stick to the position that the guarantees associated with the rescue packages will not be drawn, that the leverage of the rescue fund will not lead to an increase in the risk for Germany, and that there won't be any need of increasing the Bundesbank's equity to compensate for write-off losses. This position is no longer credible. If it should indeed turn out to be so, it would only be thanks to the rescuers making it possible for the rescued, through open fiscal transfer, to service their debt. In other words, the rescuers would repay themselves the loans they granted.

The assumption of such gigantic liabilities will sow discord throughout Europe. It will force through a transfer union which entails a stealthy expropriation of German savers and undermines trust in the state.

We fear that this is but the beginning. The public debt of the crisis-hit countries (Greece, Ireland, Italy, Portugal and Spain) amounts now to 3.35 trillion euros. We consider the establishment of systems that open the way to an expansion of the liabilities irresponsible. The German government should not agree to them.

8. Monetising public debt

The recent call of EU President José Manuel Barroso for an even more direct monetary government financing through the granting of a banking licence to the rescue fund is dangerous and would open a Pandora's box. If the money-printing press is placed at the direct service of government financing, it opens a gaping door to abuse, as Germany's wretched experience with inflation during the Weimar Republic made abundantly clear.

For one thing, the liabilities of the financially sound countries for the ordinary public debt and the Target debt of crisis-hit countries would increase even further. High burdens associated with the replenishment of the Bundesbank's equity would be well-nigh inevitable.

For another, the Central Bank could no longer fulfil its mandate of safeguarding the stability of the currency, since the incentives to submit sound budgets in future would be further weakened. The growing debt burden, associated with the already gigantic Target liabilities, would exert growing political pressure to resort to an inflationary policy, which the ECB would ultimately be unable to resist.

The stability of the currency, however, is a basic requirement for the internal peace of a society and also for the future of the monetary union. This is precisely the reason why the EU treaties prohibit the monetization of public debt. The blatant perversion of law demanded by the European Commission undermines trust in the monetary union and the stability of its currency. Were the European Monetary Union to cave in to this demand, it would definitely lose the inherent basis for its contract.

9. Eurobonds

We also regard with great concern the other recurrent demand of the European Commission, namely to introduce Eurobonds or other type of community funds. Eurobonds would again trigger a massive exodus of capital from Germany, like that which stunted its economic growth for so long, with the same negative effect this time around. They would encourage the peripheral countries to take on more debt, perpetuating the conditions that led to the crisis in the first place. In particular, Eurobonds would again set in motion the capital flows that led to the current account imbalances, further cementing them.

The yields currently demanded for Italian and Spanish debt, described by some as intolerable, are within the levels that Germany itself had to pay during the 1970s and 1980s, and far below the rates that these countries had to pay before they adopted the euro. We do not share the opinion that the markets are exaggerating the risk and that, for that reason, measures to check the yields are called for. There is still a chance that the interest rates will stabilise at a high level.

Eurobonds would be inordinately expensive for Germany, since they would increase the interest burden on German public debt by many dozens of billions of euros per year. Eurobonds with joint liability were rightly prohibited by the German Constitutional Court; if Eurobonds with pro rata liability were the financial instrument preferred by the markets, they would have been long offered by private investment funds.

We evaluate in similar terms the proposal of the German Council of Economic Experts of setting up a European Debt Repayment Pact, circumventing the Maastricht Treaty. The belief that such a fund can be equipped with binding rules to repay the debt will not be able to withstand the political pressure. At best, the Debt Repayment Pact will serve as a pathfinder for Eurobonds, since if Germany accepts liability for part of the debt, the pressure will be strong for it to be liable for the rest of it too, in order for the guarantees for the one part not to be drawn yet. The Debt Repayment Pact represents a hazard to the stability of the Eurozone in general and for Germany in particular.

10. Restrictive rescue policy

The only policy that can save the euro is one of a restrictive nature that keeps rescue funds short for over-indebted countries, forces a correction of wrong price structures, and allows those countries to go bankrupt that despite ample liquidity assistance cannot or will not help themselves. There must be a middle way between denying help to stricken neighbouring countries and the establishment of a self-service shop for government financing.

Politicians are tending at the moment towards ever larger rescue packages and believe that they can preclude abuse by imposing conditions on the recipient countries that reduce the scope for decision-making of the local political instances. This provokes strife because the unpopular measures are attributed to the helping countries and not to the result of local faults. Germany and Europe are cast increasingly into the role of scapegoats and are the subject of demagogic attacks.

Better than prescribing behaviour is to restrict the rescue funds. That is the only credible middle way. It must be made possible, however, for the countries for which the restricted aid is insufficient and which would face excessive price deflation to regain competitiveness to leave the monetary union.

11. A transfer union?

If Germany rejects the possibility of creditors assuming part of the responsibility or of a country leaving the monetary union, it sends a signal that it is willing to support uncompetitive countries at any price and for any amount of time. This is a sure way into a transfer union. Given the relative size of the population of the crisis-hit countries, 40% of the Eurozone's total population, we think a transfer union is not an option.

The comparison sometimes made with the eastern German states is also off the mark. For one thing, at the time of reunification the east represented only 20% of the overall German population. For another, the eastern states are, twenty years later, still receiving sizable public support from the west. Money can only be spent once.

If the path towards a transfer union were nevertheless to be pursued, much farther-reaching reforms must be adopted before this happens that introduce a common European, federally organised nation state and that also require significant concessions from the other member states. This requires not least the complete integration of the armed forces under a joint command, a common foreign policy and the extensive surrender of national autonomy. In the best of cases this can only be achieved in the long term. It must furthermore be ensured that the transfers go from the rich to the poor countries and not, as at present, from those who abide by the rules to those who break them.

12. Interest rate spreads and current account balances

Europe is still a long way from forming a single nation state. But even if it succeeded in forming such a state, joint liability for the debts of its component states would be harmful. This is demonstrated by the example of successful political unions such as the United States and Switzerland. In the US it was necessary for a number of states to default for all of them to realize that there would be no mutual assistance. This clarification also helped to keep the debt of the states within narrow limits.

Excessive external imbalances in the euro area can only be avoided if the idea of a joint liability system is ditched and market control over capital flows is maintained instead. Only when the possibility of a sovereign default in the event of over-indebtedness exists does a growing debt lead to a rise in interest rates, which limits the debtor's appetite in taking on debt and enforces discipline. And only such market-imposed self-control can prevent the borrower's economy from overheating, and that of the lender from lingering in the doldrums, which would lead to the oft-decried current account imbalances.

It is necessary to fight the temptation of financing expenditures with debt, instead of stoking it anew with a policy of interest rate convergence. Membership of the Eurozone does not entitle any country to gain access to low interest rates through the political process. Low interest rates are an advantage that must be earned.

13. Pre-programmed conflicts

Obviously, some members of the Monetary Union are unable or unwilling, or both, to make the political efforts towards economic convergence that go hand in hand with a currency union. Together with their creditors, whose speculation did not pay off, they are now trying by means of the European rescue fund to find buyers for their toxic government bonds.

This initially led to a calming of the markets, but it also meant that the risks of the excessive private and public sector consumption of the financially unsound countries have been imposed on the economically more solid countries. In the final analysis, the latter must now take the place of the existing creditors of the indebted countries and try to collect the delinquent debts. Strife and discord among the peoples of Europe are all but pre-programmed. The Federal Republic of Germany should stay as far away from this as possible.

14. Reassuring capital markets or the citizens?

Many citizens are wary of policies that revise their promises and announcements in ever quicker succession and that seem to be lacking a sense of proportion. We do not ignore the fact that German policymakers are in a difficult position, under enormous pressure from the concentrated interests of the international financial markets and the debtor countries. But we insist that policymakers engage in an unbiased discussion of the various paths still open and that they have the courage to openly admit past mistakes and miscalculations. If you realise that you took a wrong turn and see that the goal is not getting any closer, you have to stop, retrace your steps and then set out on a new path. It makes no sense to pursue the old path even more resolutely.

A continuation of the current policy will place excessive strains on Germany and will make the country poorer, especially if it should succeed in reassuring investors by taking the toxic government bonds off their hands. This shifts the burden onto future generations of Germans and reduces their opportunities to enjoy economic prosperity and social peace.

15. Institutional debt barriers

Politicians hope that debt discipline can be achieved, even in cases of joint liability, by placing political debt brakes as part of a fiscal union. After the experience with the Stability and Growth Pact, we consider this hope to be misplaced.

Political barriers to indebtedness are of course not harmful. But the time for subduing over-exuberant creditors and debtors has long passed. The capital markets are no longer prepared to meet all the financing demands of countries in crisis, and thus foreign loans are primarily coming via the instruments of Community financing. In order to insist on debt discipline in such circumstances, political barriers that are co-defined by the borrowers themselves are not what is needed. Instead, placing limits on lending by the public creditors is perfectly sufficient.

A fiscal union with more effective intervention rights of the EU or intergovernmental bodies will, we fear, have the opposite effect of what the German government is intending. It will tend to facilitate, if not increase, lending between countries because it will give the deficit countries a political voice in accessing the loans from the bailout fund.

16. Too much competitiveness?

We consider it particularly problematic that the EU is seeking to influence the unit labour costs of the European countries through policy measures. The former French Finance Minister, Christine Lagarde, insisted last year that Germany should raise its wages in order to weaken its competitiveness vis-à-vis its competitors. The German government was able to ward off the EU penalties foreseen for countries with low unit labour costs, but the criticism of the allegedly unfair competitiveness of German industry and the attempt to weaken it by imposing wage increases are still there. We thoroughly reject them. It is definitely not any government's job to intervene in the price and wage structures of a market economy, because this distorts the steering function of prices and wages.

The fixation of policymakers on unit labour costs fails to recognise that the differences in unit labour costs in Europe largely came about as a result of capital movements, which, as we have explained, resulted from the interest rate convergence generated by false expectations and wrongly-conceived banking regulations. If the differences in unit labour costs are to be reduced, the crisis-hit countries must be allowed to become cheaper and the surplus countries must become more expensive, but for that to happen we must not encourage the flow of capital between countries via excessive bailouts and jointly secured funding instruments that lead back to a condition of undifferentiated interest rates, which would again shift economic vigour away from Germany to the periphery. If the goal is for Germany to import more and the southern countries less, the self-correction of the European capital market that started after the crisis, with more German savings capital being invested in Germany, must not be blocked. Whoever attempts through government measures to force capital out that would otherwise not voluntarily leave Germany will be responsible for maintaining the external imbalances in Europe.

Policy-induced wage increases will weaken German exports, but because of the weakening effect they could lead to a contraction of the German economy and a reduction of its imports, so that a reduction of the German export surplus would by no means be assured. What the other countries gain in competitiveness they could lose because of a reduction in German demand for their products.

17. An agenda

A resolution of the crisis can only come by addressing the real roots of the crisis. Treating only the symptoms of the disease is doomed to failure. Since there is no way to return to a policy of completely excluding mutual liabilities, at least we should strive to achieve the following.

a) The ECB should again limit itself to purely monetary policy. It cannot assume the task of stabilising the European national banking systems, much less the member states themselves. This is the sole responsibility of the individual states or the Community itself. As long as the ECB is able to shift with its policies fiscal and other financial burdens between the states, it undermines and prejudices the decisions of the national parliaments.

b) Decision-adopting rules and the allocation of voting rights in the ECB Governing Council should be modified. It is not acceptable that a body in which the voting rights are completely decoupled from liability can adopt by a simple majority measures that impose on Germany liability risks amounting to hundreds of billions of euros.

c) The Target balances between the national central banks must be settled from now on once a year with marketable assets, as in the United States, to ensure that the national central banks' money-printing presses will, in the medium term, only be used to the extent that this is necessary for the respective national money supply. A longer-term repayment plan could be arranged for the claims already accumulated. If easy access to money-printing is not blocked, the path towards Eurobonds and a transfer union is preordained.

d) Following a proposal made by the European Economic Advisory Group, a clearly defined sequence of support measures must be contractually agreed upon by the euro countries.[2] A country that faces an acute fiscal crisis should for up to two years receive liquidity help. If, thereafter, the country still is unable to pay its maturing government securities, investors must bear the liability first. The international community can only be called on to avoid excessive risk, and even this protection should be limited to a certain proportion of GDP. Only then can the incentive to exercise caution be linked with the goal of preventing a panic in the markets in the case of a crisis.

e) The EU should help the stricken countries overcome their competitive problems and offer them opportunities for an economic recovery. These include assistance for the establishment of a tax administration and a functioning legal system as well as measures to support the respective governments in privatising state assets and enforcing reforms allowing more wage and price flexibility. Community support that goes beyond the aid described in point d), however, is not helpful since it creates a dependency on such assistance and an automatic mechanism that the donor countries can no longer escape.

f) Banks must hold sufficient capital in order not to be overstressed in cases of defaults of public and private borrowers. Otherwise, the banks can continue to de facto blackmail the governments to help them, in order to avoid the economic costs of a collapse of the banking system. Higher capital reserves reduce the incentives for speculation, and in cases of crisis they create a buffer to absorb the losses. Even government securities and loans to other banks are subject to failure and must be backed in the medium term by equity capital according to country-specific risks, following the rules that apply to the loans given to midsize companies. This makes government loans and interbank trading more expensive, but it is necessary to stabilise the banking system and the countries themselves. To the extent that the banks are unable to tap the capital markets, a mandatory recapitalisation by selling shares to the government or similar measures should be introduced, both to avoid a credit crunch and to give the state the opportunity to profit from a possible increase in the value of the banks.

g) Euro countries that are not willing or objectively unable to take the necessary measures to reduce imbalances and debt should be allowed to withdraw from the euro area and revert to the status of EU countries that are not in the Eurozone. Exiting the Eurozone should be mandatory in the case of default, and the relevant procedures should be contractually set out. Only a monetary union that

[2] A New Crisis Mechanism for the Euro Area, *EEAG Report on the European Economy 2011*, Munich 2011.

remains a voluntary confederation of states with respect for the mutually agreed rules has the hope of permanency.

This declaration was published in full on the editorial pages of the *Frankfurter Allgemeine Zeitung* on 7 December 2011.

Signatories:

Roland Berger, Chairman of the Friends of the Ifo Institute (Honorary Chairman, Roland Berger Strategy Consultants GmbH)

Aldo Belloni, Deputy Chairman (Member of the Executive Board, Linde AG)

Eckhard Cordes (Chairman, Metro AG)

Wolfgang Sprissler, Treasurer (Former Executive Board, HVB)

Jürgen Hofmann (Secretary General, Wirtschaftsbeirat Bayern)

Dirk Ippen (Newspaper Publisher, including *Münchener Merkur*)

Fritz Kempter (Attorney, President of the Association of Independent Professionals in Bavaria)

Meinhard Knoche (Executive Board member, Ifo Institute – Leibniz Institute for Economic Research)

Michael Kozikowski (Member of the Board, KPMG AG Auditors)

Klaus Mangold (Internationale Wirtschaftsberatungsgesellschaft mbH)

Georg Milbradt (former Minister-President, Saxony; Technical University Dresden)

Alexander Rittweger (CEO, Loyalty Partner GmbH)

Dirk Rossmann (CEO, Dirk Rossmann GmbH)

Dieter Soltmann (former President, Wirtschaftsbeirat Bayern)

Hans-Werner Sinn (President, Ifo Institute – Leibniz Institute for Economic Research and LMU University of Munich)

Heinz Hermann Thiele (Chairman of the Supervisory Board, Knorr-Bremse AG)

Peter-Alexander Wacker (Chairman of the Supervisory Board, Wacker Chemie AG)

Georg von Werz (Chairman of the Board, Pramerica Real Estate International AG)

Otto Wiesheu (President, Wirtschaftsbeirat Bayern)

Manfred Wittenstein (Chairman of the Board, Wittenstein AG)

Ewald Woste (Chairman of the Board, Thüga AG)