March of the German economists

German court may hedge ESM with new restrictions Finland exit threat shows EMU fraying

by David Marsh

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The backlash against Germany's apparent readiness to dig still deeper into taxpayers' pockets to stem the euro's malaise is gathering momentum. As Finland fuels alarm over a possible fraying of economic and monetary union (EMU), a protest action by 172 German economics professors against Chancellor Angela Merkel's agreement on direct recapitalisation for ailing European banks has sparked a war of words with the Berlin government.

Ahead of Tuesday's deliberations by the German constitutional court on German support for the ESM permanent rescue fund for the euro area, federal president Joachim Gauck said on TV yesterday he approves of plaintiffs' actions against the fund as a way of bringing 'clarity' to Germany's EMU obligations.

This has been widely interpreted in Germany as an important warning shot across Merkel's bows to prevent her from riding roughshod over constitutional and parliamentary niceties. The court is highly unlikely to stop the ESM but may hedge it in with extra restrictions and controls that could hamper its effectiveness.

Wolfgang Schäuble, the finance minister, says he's 'indignant' at the academics' protest. Merkel claims the end-June summit changed nothing because the bank recapitalisation measures have yet to be voted on by parliament.

However there is growing anxiety in Germany that France is on a collision course with Germany over economic and social policy following the election of Socialist president François Hollande.

In the aftermath of the Brussels deal on banking, once again, Merkel's Law of Permanent Disappointment has come into play. The capital markets say latest concessions are not large enough to tackle the euro's problems. Yet they are far too large for Merkel's conservative critics, who say she has gone too far to prop up errant states.

The economists say steps towards a banking union threaten mutualisation of European debt for an amount three times larger than government borrowing. Total bank deposits that could come under the shield of mutual insurance add up to 'several trillion euros' in the five worst-hit European countries, according to the academics, led by Hans-Werner Sinn of the Munich-based IFO research institute.

Prof. Sinn has progressively stepped up complaints about the risks to the Bundesbank's balance sheet of lending to the European Central Bank under the Target-2 automatic intra-euro area payment system. According to latest data, Bundesbank Target-2 claims on the ECB rose to €729bn in June from €699bn in May and €337bn in June last year.

The German economists' statement, labelling as 'wrong' the decisions rubber-stamped by Merkel at the Brussels gathering, is much more negative and a great deal more political than various anti-euro attacks by German economists in the run-up to the single currency's introduction in 1999.

The impression that individual countries are eyeing the exits has been heightened by the threat of Jutta Urpilainen, Finland's finance minister, to leave the euro rather than shoulder responsibility for other countries' debts, and by the Cyprus government's intention to seek a €5bn loan from Russia to sidestep austerity measures demand by the European Commission in return for European bail-out funds.

Jens Weidmann, Bundesbank president, maintained a drumbeat of concern by stating that the latest summit brought no clarity on EMU's future and ruling out further resort to 'printing money'. Weidmann – an adviser to Chancellor Merkel before he moved to the Bundesbank in May 2011 – said the Berlin government's plans for an 'integration push' in Europe could not be enacted within a short time-frame, dampening hopes that common banking supervision at the European Central Bank (ECB) could open floodgates of money for peripheral states.

Weidmann's words, and his repeated warnings about aligning ‘liability’ and ‘control’ in European finance, echoed a statement last week from the government's own council of independent economic advisers.

On Friday, Jörg Asmussen, an ECB board member, became the latest central banker to complain that too much was being expected of the Bank. A day after the ECB cut interest rates to a record low 0.75%, he said: ‘We must explain what the limits of our powers and mandate are.’ Rejecting calls by the International Monetary Fund and several European governments for bond purchases by the ECB to shore up peripheral states’ debt, he said: ‘The ECB cannot compensate for what others - notably political authorities - fail to do…. There is no substitute for good policies.’