Stoiber and Steinbrück call for return of debt brake

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Edmond Stoiber (CSU) and Peer Steinbrück (SPD), former chancellor-candidates for their parties and long-time prime ministers of Bavaria and North Rhine-Westphalia, are worried about financial and monetary policies after the German election. They expect inflation to rise rapidly, fear 'social explosion' and warn of 'massive social upheavals' and political polarisation. In the pandemic, all inhibitions about government borrowing have fallen by the wayside. The Merkel / Scholz government has broken records for indebtedness year by year. By 2026 the EU wants to borrow more than €800bn for the coronavirus fund The ECB is pursuing a policy of extreme monetary easing. Will the next federal government, however constituted, have the strength to return to sound, sustainable financial and monetary policies? Stoiber, Steinbrück and fellow campaigners are voicing substantial doubts. They are making far-reaching demands on politicians and the central bank. This paper was written as the result of a broad, open, sometimes controversial exchange of views with serving officials, for example with Bundestag President Wolfgang Schäuble (CDU) and Bundesbank President Jens Weidmann. Sigmar Gabriel, former SPD chairman, also participated in the discussion. 'You have to stick with it,' Schäuble told the authors.
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Perspectives for sustainable financial and monetary policies in Germany and Europe
The ultra-expansionary monetary policy of the European Central Bank (ECB), which has been pursued for years, also at times of economic growth, has led to short-term economic stabilisation in a number of monetary union members. The ensuing massive monetary overhang has created unmistakable long-term risks. This overhang not only creates the potential for inflation and jeopardises long-term financial stability. Furthermore, because it was largely created through the acquisition of government bonds, it creates the illusion among euro member states that they can permanently finance rising government spending at zero and negative interest rates, even without growth-promoting reforms. The ECB has now effectively made euro member states, as owners of the national central banks, into guarantors of the liabilities so created.

The ECB's actions give the impression that monetary union can be maintained only by breaking the rules formulated by the member states themselves (e.g. Maastricht criteria, no bail-out clause, ban on monetary state financing). In fact, to make the euro area sustainable, a functioning, rules-based, controllable and enforceable set of rules is necessary, enforceable with penalties. The aim must be to increase all member states' competitiveness to face economic and geopolitical challenges in a united and economically successful fashion. This is the only way to continue the European integration process, which we consider indispensable.

There are already increasing signs of increasing inflation

If the ECB continues its ultra-loose monetary policy, we see six massive medium-term dangers:

- Signs are increasing of rising inflation. To meet its price stability target, sooner or later the ECB will have to reverse government bond purchases and cautiously raise interest rates. In most-affected member states this could severely disturb financing of governments and banks, unless these governments make determined efforts to consolidate budgets early on. On the other hand, failure by the ECB to control rising inflation would lead to massive social upheaval and income disparities. Rising consumer prices hit hardest citizens with lower incomes and wealth. History shows that such developments can lead to social explosion and political polarisation.

- Ultra-expansionary monetary policy can lead to structurally weak growth. Permanently negative ECB interest rates can solidify uncompetitive economic structures and reduce incentives for EU countries to enact growth-enhancing structural reforms.
- Germany's successful social market economy is being undermined by state intervention, giving way to a new model of contemporary normality. Economic actors are becoming accustomed to the state covering and providing security against economic risks, eclipsing individual responsibility and market-orientated selection processes.
- The ECB's ostensibly all-healing monetary policies have supplanted the task of politics in setting spending priorities, ultimately overstretching states' financial capabilities
- The European banking system has been weakened. Since the 2008-09 financial crisis, European banks have lost significant ground internationally. However precisely this crisis has shown that a stable internationally competitive banking system is an important prerequisite for a strong European economic area in relation to other major economies.
- For the first time, the EU Commission is taking on large-scale debts jointly guaranteed by member states. These need to remain a one-off exception; otherwise EU cohesion will be endangered. EU borrowing with joint liability will lead to fundamental disputes between 'rich' and 'poor' member states and endanger Europe's unity and solidarity. Similar effects can be expected if, in an environment of rising inflation, the ECB had to choose between the goal of price stability and further public financing.

To counter these dangers, Europe must return as soon as possible to a solid, sustainable financial and market-based growth policies, with a gradual scaling back of new government borrowing.

We expect the future federal government to

- develop a concept for step-by-step reduction of new debt and compliance with the constitutional debt brake, as soon as the economic situation permits. Abolishing the debt brake would be unacceptable from the point of view of intergenerational equity
- develop a national growth strategy, also in the interests of intergenerational equity, which includes a tax moratorium for companies and citizens, an internationally competitive tax policy, and a climate protection policy based on market economy principles and investments securing the Germany's industrial future specifically in terms of research, education and infrastructure
- demand compliance with the European treaties, in particular the 'no bail-out' clause (Art. 125 TFEU) and the ban on monetary state financing (Art. 123 TFEU)
- work to ensure that the European reconstruction fund remains limited to overcoming the corona crisis and does not become a permanent establishment. The new European liabilities must be added to the national government debt in accordance with portions guaranteed by member governments. Joint liability must be excluded. Debt redemption should be brought forward to well before 2058, to create financial leeway to deal with future economic setbacks
- demand a reform agenda from other euro member states to improve or restore national and euro area competitiveness. Countries badly hit by the pandemic, such as Italy or Spain, have a right to European solidarity. But solidarity is not a one-way street. The Federal Government must insist on an effective control mechanism (for example by the Ecofin Council or the EU Commission) that ensures that the funds from the reconstruction fund are used to promote growth, not consumption. Only in this way can the fund serve as a bridge to enable the ECB to shift from its permanent role as a source of emergency aid

- advocate a reform of the European Stability and Growth Pact, aimed at increasing the efficiency, simplification and transparency of EU countries' debt, including national shares in the reconstruction fund.

The ECB must return to its core task

We expect the European Central Bank to

- concentrate on its core task of ensuring price stability. A symmetrical inflation target debated in central bank circles would not be in line with the EU treaties. So that the financial markets can adjust to this in good time, the ECB should make clear in its public communication that it is willing to start gradually reducing the volume of government bond purchases and, after overcoming the corona crisis, to reduce its holdings of government and, with that, the inflated money supply
- until then to base its purchases of government bonds strictly on the capital key of the national central banks and not give preference to certain highly indebted countries. Under no circumstances may the ECB give in to demands to write off all or part of its acquired government bonds or turn them into perpetual bonds to provide states with debt relief
- comprehensively and regularly carry out the proportionality test called for by the Federal Constitutional Court and, above all, provide up-to-date information about the immense risks and side effects of monetary policy. These include risks to financial stability, potential for inflation, already evident in asset prices, and negative effects, for example on savings and old-age provision
- waive preferential treatment of 'green' corporate bonds, part of its support for the European 'green deal', both in terms of acquisition and collateral valuation. Dealing with climate change is a matter for democratically politics, not the ECB, which has no mandate for such policies and which is not answerable to the electorate

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