LETTER FROM BERLIN

Finance Minister Schäuble Slams on the Brakes

By Klaus C. Engelen

As Germany's people and politicians are having nightmares over the worsening refugee crisis—where most EU members are shutting their borders or redirecting the incoming masses toward Germany—the realization is sinking in that European solidarity is only a one-way street.

Germans recall with anger how some EU member countries—especially in the euro area—had to be rescued during the banking and sovereign debt crisis with the help of German taxpayers. Germany does take into account that German banks and investors were bailed out with taxpayer money and guarantees. But the fact is that European solidarity was overwhelmingly cited as justification as recently as the third Greek rescue operation in the amount of €86 billion.

Daniel Gros of the Centre for European Policy Studies argues, "Without anyone quite noticing, Europe's internal balance of power has been shifting. Germany's dominant position, which has seemed absolute since the 2008 financial crisis, is gradually weakening—with far-reaching implications for the European Union."

Gros predicts German economic growth will fall below that of the other large euro area countries—France, Italy, and Spain. The German economy seems set for a protracted period of sluggish performance. With interest rates at zero, Germany's large savings are no longer doing it much good. And as Germany is thrust into the front line of the refugee crisis, it has to ask its EU partners for solidarity as it cannot absorb all the newcomers alone. The ongoing shift in Europe's power dynamics is likely to weaken Germany's enforcement of the eurozone's fiscal strictures.

With such gloomy prospects, it is unlikely Germany will follow the call for "more Europe." Indeed, German reaction to the ambitious plans to deepen the economic and monetary union has become rather hostile.

European Commission President Jean-Claude Juncker, together with European Council President Donald Tusk, Eurogroup President Jeroen Dijsselbloem, ECB President Mario Draghi, and European Parliament President Martin Schulz, put forward concrete measures to be implemented during three stages. Some of the actions need to be frontloaded in coming years, such as introducing a European Deposit Insurance Scheme, while others go further, such as creating a "future euro area treasury." This would ensure, they say, moving beyond rules toward institutions in order to guarantee a rock-solid and transparent architecture for monetary union.

What Juncker, Draghi, and Co. are proposing is a European deposit insurance system that in its first stage would establish obligatory re-insurance among the existing national deposit guarantee systems of the euro area countries. In a second stage, a co-insurance system in the form of a single deposit fund would establish a cross-country mutualization scheme. This would mean that the deposit protection schemes of Germany and some other countries with well-funded deposit protection systems would be forced to fill the looming deposit protection gaps in other euro area countries. The German Banking Industry Committee (DK), representing all German bank groups, protested loudly against this "potential transfer union." Germany's banks "unreservedly support the German government's reiteration of its criticism of further steps to link or even mutualize deposit guarantee schemes within the EU."

What is also causing a lot of irritation in Germany, especially within the Bundesbank, are the EU Commission proposals for securing a single representation in the International Monetary Fund so that the euro area can speak with one voice. At the ministerial level in the IMF, the euro area would be represented by the president of the Eurogroup, and at the IMF Executive Board by the executive director of a euro area constituency,

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Klaus Engelen is a contributing editor for both Handelsblatt *and* TIE.

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Phone: 202-861-0791 • Fax: 202-861-0790
www.international-economy.com
editor@international-economy.com

following the establishment of one or several constituencies comprised only of euro member states. This would mean that the German government and the Bundesbank would have to yield control of German foreign reserves at the IMF to new European Commission representatives.

No wonder Berlin's official reaction was sharply critical. "We have to make sure not to put the cart before the horse," Germany's Finance Minister Wolfgang Schäuble shot back. Speaking also for some of his finance minister colleagues, Schäuble countered, "We must implement what we already need to complete: the other two pillars of banking union: supervision and an agreed system to handle failed banks."

Fighting back, Berlin laid down its "red lines" in a "non-paper" that was handed out at an informal finance ministers' meeting in Luxembourg. It reflects the deep German resentment against a Juncker-led Commission wanting to speed up, with the encouragement of France and others, further integration steps as a "classic case of Europe seeking to put German taxpayers' money where the EU's mouth is," according to the *Financial Times'* Brussels Blog. Berlin's key message: "To now start a discussion on further mutualization of bank risks through a common deposit insurance or a European deposit reinsurance scheme is unacceptable."

Some of the non-paper's points: monetary union needs a stronger banking union, but must get it right. The Greek experience has made clear that not only can bank failures imperil public finances, but political failures can destabilize banks. Therefore, there are two sides to the nexus of sovereign risks and bank risks which have to be addressed. This requires an effective resolution mechanism, including effective bail-in rules (which in the case of the Greek bank capitalization have been blocked by the European Central Bank), as well as effective supervision and resilient banks. Sovereigns should not be able to pull banks into financial distress (as in Greece).

Especially irritating to Germany is the Juncker Commission's push to unveil plans for a "more common deposit guarantee system" for banks before the end of the year. This comes as Berlin is still licking its wounds from the third Greek rescue. Germany was thwarted by the ECB—with Brussels backing—in its effort to impose losses on large depositors at Greek banks as a way of providing funds for the €25 billion recapitalization of the Greek financial sector. Such a bail-in could shatter market confidence and be a systemic risk, argued the ECB. From Berlin's point of view, this meant that all euro leaders' pledges in recent years that bailouts are a thing of the past turned out to be void. Again, taxpayers had to foot the bill.

In the "non-paper," Berlin also insisted on further steps to ensure that private creditors of highly indebted governments take losses, thus preventing bailouts as a way to let the money flow to creditors while putting the burden on taxpayers. Berlin wants the European Union and eurozone countries to commit quickly to specific regulatory steps to reduce the level of sovereign risk on bank balance sheets—instead of waiting for global agreements through the Basel Committee and the Financial Stability Board.

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When the ambitious plans of the five EU presidents were followed by the call from French economic minister Emmanuel Macron "to set up permanent transfer mechanisms to channel funds from the richer states to countries in difficulty," that may have been too much for Schäuble to stomach.

In a speech to students at Sciences Po in Paris, reported by *Frankfurter Allgemeine Zeitung,* Schäuble rejected Macron's far-reaching plans. He suggested the students "ask themselves whether they would accept decisions that are not taken by your national parliament, but by a European institution."

According to Eurointelligence, "There is no evidence that the French readiness for relinquishing national sovereignty is any bigger now than in 2005, when the country voted down the EU Constitutional Treaty in a referendum."

After hundreds of billions of euros and guarantees—and trillions in ECB support—were spent to help banks and weak euro sovereigns, the safety of savings in a country of savers like Germany remains a sensitive issue. Germany's politically influential savings and cooperative banks are warning politicians of all parties that their eighty million bank clients also are voters. "This explains why the Brussels plan under which bank customers would be pushed into a cross-country mutualization scheme, which nobody who contributes can control because national deposit guarantee systems will become liable for risks in other countries, is hard to sell in Germany," says Gerhard Hofmann, managing board member of the National Association of Cooperative Banks.

When talking about the safety of bank savings, the history of high inflation and loss of financial assets is part of the German DNA. Ingrained into post-war Germany's memory is a Berlin press conference on October 5, 2008, at the height of the bank crisis, when the looming insolvency of the huge Hypo Realestate Holding AG threatened a panic among bank customers, and Chancellor Angela Merkel—flanked by her finance minister Peer Steinbrück—announced: "We want to tell savers that their deposits are safe. The government will vouch for that."

The latest news from Brussels is that Juncker is offering Berlin exemption of Germany's public sector and cooperative banks from the EU deposit insurance legislation in order to break the deadlock in the debate. This shows Schäuble's putting-on-the-brakes manoeuvre seems to have worked. ◆