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The Derailed Policies of the ECB

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Target balances and the euro crisis

The problems revealed a few months ago by Hans-Werner Sinn[1] of the Target balances between the ECB and national central banks (NCBs), especially the Bundesbank, on the one side, and the NCBs of the peripheral countries, Greece, Ireland, Portugal Spain, and recently Italy (GIPS countries), on the other, has made clear that there are serious institutional weaknesses in the Eurosystem and significant negative developments in the euro area that in terms of their scope and dangers go even further than the sovereign debt crisis and the rescue plan constructed by the euro countries, both of which are the subject of public controversy (first Greek rescue plan, EFSM, EFSF).

Triggered by the massive deficit in the Greek state budget that emerged into public view in late 2010, the political and economic interest focused mainly on excessive debt financing in Greece and Portugal, the housing bubble in Ireland and Spain, the associated effects on the banking systems in the euro area and the reaction of the financial markets. The policy measures to avert an alleged second 'Lehman crisis' are well-known: the provision of a rescue plan for Greece, Ireland and Portugal and perhaps for Spain and Italy, with certain requirements for fiscal and economic policy and the assumption of bank risks by taxpayers. The excessive public and private debt, however, is only the tip of the iceberg of a deep-seated balance of payments crisis within the euro area as a result of external economic abuses that were largely unnoticed before the crisis and that had arisen since the introduction of the euro.

The Target balances are a kind of 'missing link' that make apparent the relationship between the publically discussed sovereign debt and banking crisis of the GIPS countries and the external imbalances that have arisen in the form of balance of payments crises in the euro area. European policy-makers do not seem to have fully grasped the actual extent and causes of the crisis, since up to now the measures have not been suitable for solving the real problems. To some extent they are even counterproductive. The massive external imbalances are only mentioned in passing if at all and play no or only a very minor role in the rescue measures taken thus far.

In the public discussion, the term 'euro crisis' is primarily used, which seems to suggest that the euro as a currency is in jeopardy. Fortunately, we have not yet had a crisis that involves excessive inflation or exchange rate depreciation[2] but a crisis of the currency area and the monetary union, as some countries are not willing or able to shoulder the duties and consequences that come with a monetary union, and since doubts have arisen as to whether this will improve in the foreseeable future. There are also serious construction defects in the monetary union and glaring weaknesses in the implementation of the rules. However, there are inflation risks in the medium term if the monetisation of government debt is not halted.

The failures that led, on the one hand, to massive imbalances between countries within the eurozone in the area of foreign trade, the private capital flows and competitiveness, and, on the other hand, excessive public and private debt in the GIPS countries are a *direct result of European Monetary Union*. They did not occur in the previous system of national currencies with more or less flexible exchange rates, since a policy of exchange rate stabilisation *via* intervention in currency markets would, with the great extent of

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[1] The first public statement dated from the end of February 2011 (Sinn 2011), which triggered a debate among experts in Germany and abroad; the discussion helped allay initial misunderstandings and misinterpretations. For the latest presentation of the Target arguments, see Sinn and Wollmershäuser (2011) and the literature cited there.

[2] The average inflation of the euro was lower than in the period of the deutschmark (DM), and the euro has become more expensive against the US dollar. However, this assertion must be seen in the proper perspective. It is problematic to compare the DM period with that of the euro, since the global economic challenges were very different. Due to the obvious weakness of the dollar and the US economy, a look at the dollar alone is not sufficiently informative. Comparing the euro with the Swiss *franc*, which has always been regarded as a haven of stability, the performance of the euro is not quite as impressive. The same applies to the comparison with the Nordic currencies outside the euro area.

real economic imbalances, have quickly reached its limits and would have brought about exchange rate realignments.

Today's problems can thus be *causally attributed to the euro*; the global financial crisis of 2007 to 2009 that began in the United States only made them apparent. The constant reference to evil speculators, biased rating agencies and the call for restraining the international financial markets is neither a sufficient explanation of the problems nor a useful strategy. It serves only to divert attention from the real problems of the eurozone and in particular from the design flaws for which policy-makers are responsible and from other wrong policy decisions at the national and European levels. The impression arises that some policy-makers have not taken note of, or are not willing to take note of, the inner mechanics of a monetary union and the potential dangers; instead they look for scapegoats that they can present to the general public.

In retrospect, the first euro years appear idyllic. One can compare it with sailing in fine weather, which is possible with a second-rate boat, inadequate equipment and an inexperienced team. Policy-makers and the ECB were living with a false sense of security, even though the storm was approaching. When it finally broke and the suitability of boat, crew and equipment were put to the test, the inherent weakness and lack of preparation for possible dangers became apparent. A monetary union with strict rules consistently enforced had not been created, and now a heavy price had to be paid. Since then, we have witnessed constantly incoherent and often counterproductive quick fixes that only undermine confidence in politicians and institutions.

Advantages and disadvantages of monetary union

At the latest, since the discussion triggered by the later Nobel laureate Robert Mundell in 1961 on optimal currency areas, the economic advantages but also the disadvantages and weaknesses of monetary unions are widely known. Since the euro was introduced for an economically suboptimal and highly inhomogeneous area and the monetary union was regarded as less an economic than a political project in order to achieve the political unification of Europe or even to force it in through the back door, it was particularly important to be aware of the inherent dangers and mistakes, and counteract them through meaningful institutional safeguards and wise policies.

We know from economic history that all monetary unions between equal partners[3] have failed because the centrifugal forces in the emergence of very different economic developments in sub-regions and the institutional disincentives were not gotten under control. The advantages of monetary union are undisputed and were constantly stated even before the start of European Monetary Union and still are today. The main pro-arguments are:

- A monetary union reduces the transaction costs through the elimination of currency risks.
- It eliminates the location disadvantages, particularly for smaller sub-regions.
- It allows these regions to receive better conditions for financing investments *via* a large, common capital market.
- It facilitates economic integration.
- It promotes the division of labour.
- And it can thus lead to higher overall growth and prosperity in the currency area, especially in the smaller sub-regions.

In addition there are specific policy arguments:

- The euro should strengthen a European sense of belonging together.
- It should enable a real political union with a strong European government and an influential parliamentary.[4]
- It should replace the Bundesbank with its dominant influence on monetary policy in Europe with a common central bank on which all euro countries would have equal influence.[5]
- It would irreversibly tie reunited Germany to the European Union.[6]

[3] These do not include monetary unions between a dominant partner, who has the undisputed leading role and who dominates the currency area in practice, and one or more subordinate partners who can only adapt but who have no decisive influence on monetary policy in the union as a whole. These include for example the former Belgian-Luxembourg Monetary Union, the still-existing currency union between Switzerland and Lichtenstein and the monetary union between the Federal Republic of Germany and the GDR lasting three months in the summer of 1990, as well as monetary unions with dependent areas, especially colonies or post-colonial countries. It is especially interesting again today to read the one-sided and strict rules of the German-German treaty on economic, monetary and social union of 1990 with regard to the Bundesbank and the economic and fiscal-policy competence of the GDR and to compare these with the Maastricht Treaty of 1991 that was negotiated shortly thereafter.

[4] The Bundesbank and German policy-makers were of precisely the opposite view in the discussion about the Werner Plan from the late 1960s to 1990. The monetary union was seen as the culmination of the political union and not as an instrument for achieving the same. The historical model was the introduction of the Mark as a common currency in 1873 after German unification in 1871 and not earlier during the period of the *Zollverein*.

[5] In particular, politicians from the previously soft-currency countries wanted to achieve a monetary policy that was less stability-oriented.

[6] Some saw in the monetary union a political price that Germany should pay France in return for unification. The danger that a reunified and strengthened Germany might pursue its future outside European integration or might seek to dominate Europe would thus be counteracted.

In the political and to some extent also in the economic discussion, the disadvantages and dangers of a monetary union usually played only a minor role:

- In a monetary union the participating countries lose competency in the area of monetary policy, which is an especially large problem for inhomogeneous sub-regions. For this reason, a high degree of flexibility of prices and wages in particular downwards is needed as well as migration from the depressed to the booming regions and a greater stability-policy orientation of fiscal policy that remains a matter of national competence.
- Debts under a common currency are in fact foreign currency debt, since the participating countries have lost the right to create their own money. This, however, increases the insolvency risk for sovereign debt, a risk which, from an investor's perspective, counteracts the positive effect of an elimination of exchange-rate risks.
- As a last resort to compensate for various developments and maintain a monetary union there remain only transfer payments, which are not oriented on the different wealth or per-capita income of the countries and which could be part of a meaningful financial compensation, but which are paid by the rule-abiding, adaptable and willing countries to those who cannot or do not intend[7] to meet the economic requirements of the monetary union.[8]

The very measures taken to stabilise the monetary union and the resulting danger of an extensive liability union with uncontrolled transfer flows also poses a significant political risk:

- The moral hazard effect in the recipient countries, the shift of political responsibility to the donor countries and Europe, Europe as a scapegoat for its own mistakes.
- The softening of the conditionality of aid, since under the present constitution of Europe it will not be possible in the long term to treat a member country as a protectorate, in which national parliaments and governments are made subordinate to democratically insufficiently legitimised European bodies in Brussels.[9] Greece cannot be governed from Brussels!
- The increasing alienation of European nations that may even extend to open strife and damage to the European idea.

The hopes and promises of German policy-makers at the time of the introduction of the euro were to exclude undesirable developments in the monetary union through institutional arrangements. Here, a key role was played by:

- the stability criteria,
- the mutual exclusion of liability and
- an ECB based on the model of the Bundesbank with far-reaching political independence and a 'depoliticized' currency.[10]

The history of the so-called Maastricht criteria and their sanction mechanism is well-known. They were insufficient, were weakened and made subject to political opportunity. The proposed reforms will do nothing to change this in principle. It is not to be expected that the far-reaching domestic and external economic mistakes will be corrected with more stringent and extended rules and that these mistakes will be avoided in future.

The mutual exclusion of liability was stood on its head in the rescue packages. The corrective function of the capital markets to force economic adjustments *via* interest rate differentials will continue to be weakened or even eliminated. The problem of external imbalances will thus not be confronted. The policy of the ECB to bail out countries and banking systems through the purchase of the government bonds of the GIPS countries without quality collateral has the same negative effect. The events of recent months have made this clear. It was not the stability criteria, the sanction mechanisms or even the public pronouncements and decisions of the ECB that brought about the long-postponed measures to consolidate and strengthen competitiveness in Italy or Spain but rising interest rates on the capital markets.

Current account deficits and capital imports after the introduction of the euro

The interest rates on government securities of the euro countries initially converged about to the

[7] Liable under the rescue plan are even relatively poor countries such as Slovakia and Estonia for the much richer Ireland and the still relatively wealthier Greece and Portugal. Since at least in the case of Greece, sooner or later direct or indirect transfers will be paid, poor countries will be paying to a richer one. This has little to do with the conventional understanding of solidarity and compensation.

[8] Unsound public finances are not the sole cause. Just as much responsibility is borne by a non-productivity-oriented wage policy, which affects the competitiveness of an economy, and excessive private and public consumption, excessive private debt and an insufficiently regulated banking sector.

[9] The constitutional quantum leap to a federal Europe, which is needed to solve the problem, with a strong government and a powerful parliament on a democratic basis instead of the current more cooperative structures, seems to me to be an illusion for the foreseeable future.

[10] See the insightful article by Issing (2011).

German level as a result of the euro, because the exchange rate risk disappeared and because the markets undervalued or did not take seriously the increased risk of bankruptcy brought about by the monetary union because they did not believe that the no-bail out clause would be enforced, which in retrospect was not such a wrong assessment. Added to this was the fact that the bank supervisory authorities rated government securities as fundamentally risk-free, thus giving them a competitive advantage so that the banks did not need to take precautions regarding additional capital reserves, which ran contrary to the so often proclaimed financial stability.

Since the markets assessed the risk of bank failures as extremely low, there was a widespread convergence of interest rates in the euro area, which, as H.-W. Sinn has argued, made possible a massive capital inflow to the GIPS countries, especially from Germany, and to a growing current account deficit of these countries.

If the foreign capital had flowed primarily into productivity-enhancing investments, such as direct investments by German companies, no objections could be raised as this would have brought about growth and competitive stimulus in the GIPS countries, which would have allowed these countries to sustainably service the capital that had flowed in; the capital markets in these countries were not very effective before monetary union.

However, policy-makers and the ECB tolerated oversized current account deficits which financed the additional public and private consumption or bad investments and real estate bubbles. This went hand in hand with wage-price increases, which undermined *the competitiveness before the crisis and made an improvement in the current account balance* difficult or even impossible. The economic models of the GIPS states and their above-average growth were based on a continuous import of private capital for unproductive purposes, which was unrealistic.

Lasting and disproportionate external deficits, however, are an existential danger in a monetary union[11] since a monetary devaluation to correct such a development is no longer available. Neither national governments nor the bank supervisors took action against such a dangerous development; governments even assisted this development in part through spending programmes financed by an excessive expansion of national debt, and succumbed to the illusion of lasting prosperity on credit, because this was extremely beneficial for domestic policy and for electoral purposes. From a national perspective, this is understandable but short-sighted.[12]

The European institutions, notably the ECB did little to counter this trend. Although an interest rate policy differentiated by regions is not possible in a monetary union, no direct counter measures were taken, for example *via* fiscal policy, which largely remained a national competency, *via* competition enhancing structural policies or by a stricter banking supervision. Since also no public warnings were issued at European level, we can assume that in general the dangers were underestimated. The creditor countries, in turn, basked in their own export successes.[13] Even economists did not see the gathering storm. Quite obviously there was an insufficient awareness of the precise interlinkages and the extent of the danger.[14]

The beginning balance of payments crisis and the role of the ECB

The global financial crisis changed the behaviour of investors from mid-2007, as the analysis of Sinn and Wollmerhäuser (2011) clearly shows. Risks were examined more closely and critically. The capital inflows to the GIPS countries stopped and were later replaced in part by flows in the opposite direction: repatriation of capital and capital flight. This created a classic balance of payments problem that we are familiar with from countless cases in the past.

In itself such a development in a functioning monetary union would have to lead to an albeit very painful process of normalisation and the disappearance of

[11] Unless they are offset by permanent transfers.

[12] It could also have been a well-thought-out strategy of national governments to make subsequent transfer payments necessary.

[13] The tendency of German politicians and the public to one-sidedly measure the success of economic policies in terms of export surpluses has certainly contributed. This reminds me of the behaviour of some small construction companies in eastern Germany after reunification which tried, without taking the creditworthiness of their clients into consideration, to obtain and fill as many orders as possible, and which later fell into considerable difficulties if the clients did not pay. The sale of goods and services on credit – an export surplus is nothing else – only makes sense for the economy as a whole if you receive valuable claims or profitable assets. Otherwise, one has only produced gifts. Since capital exports and trade surpluses usually occur for different business entities, in microeconomic terms an export surplus is still worthwhile. If the claims from capital exports are not serviced, a microeconomic damage occurs for the capital exporter or the taxpayer if the latter has guaranteed the capital export. The aggregate balance of such a transaction is negative. What has happened is that gifts to foreign countries have been produced, and money and effort spend on this. For the exporter, this has the effect of an export subsidy.

[14] Certainly some of the obvious problems in Greece were seen early on; they could not be overlooked. They were tolerated politically and regarded as insignificant.

current account deficits. In the absence of private capital inflows, a current account deficit can only be financed for a certain time by selling off one's own assets, and then, *ceteris paribus*,[15] central-bank money flows from the deficit countries to the surplus countries. This in turn, as in the case of the gold standard, leads to a contraction of economic activity, in the ideal case to a rapid adjustment downwards of prices and wages, a reduction in imports and an increase in exports. A solution of devaluation, as in the Bretton Woods system, or with flexible exchange rates is not possible, unless a departure from the monetary union and a re-nationalisation of monetary policy is allowed.[16]

In this situation the ECB allowed or even actively aimed at the supplying of the private banking systems in the deficit countries with sufficient central bank money (created in these countries) to settle the balance of payments deficits *via* the Target system. This compensated for the lack of private capital inflows as well as capital repatriation and later the capital flight, by which a painful contraction of the economies and, ultimately, a reduction of current account deficits were prevented. The Target balances that arose this way rendered ineffective the last remaining convergence mechanisms in the European Monetary Union.

Whether policy-makers were aware of this at the beginning of the development in autumn 2007 is not known. Perhaps they assumed or hoped that these were only temporary spikes that are not uncommon in the case of settlement balances. The underlying problem seems to have been overlooked initially. After the Lehman crisis in autumn 2008 when economic stabilisation and recovery of the banking systems were correctly given absolute political priority, there was even a certain justification for this approach; it would certainly not have been appropriate to tackle the balance of payments crisis in addition to the global economic and financial crisis at the same time. This facilitated the further increase of the Target balances by means of the expansionary monetary policy utilised by the ECB.

To the extent, however, that the immediate problems such as the Lehman crisis in the banking sector were dealt with and (thanks to shrewd financial and monetary policies) the recession was also overcome, there was no need for a justification of the further growth of the Target balances. However, this was the point at which these balances should have been reduced.

Instead of doing this, the ECB and NCBs continued their policy and financed the balance of payments problems in the GIPS states[17] through central bank money creation.[18] In addition, they lowered the requirements on the quality of the collateral required by banks. Thus the ECB increasingly financed the GIPS banking systems and assumed banking risks on a large scale. As with the beginning of the Greek crisis the solution of the sovereign debt problems become increasingly urgent, the ECB called for rescue packages from the other euro countries, which were indeed granted in May 2011. This pioneering role of the ECB is an indication that at least partially it recognised the problem of its policy. The Target balances were nothing more than unofficial rescue packages for the affected economies and banking systems, a kind of ECB overdraft that was to be replaced by the official rescue packages of the euro countries.

Of course, from the perspective of the deficit countries the loans *via* the Target balances are much more attractive than the loans *via* the official rescue packages, since the latter are granted almost automatically without complicated application procedures and testing, come with no obligations and are provided at a favourable interest rate. Instead of formally borrowing money from the rescue funds in order to undertake the stabilisation of their own banking systems, it was and is much more convenient to let the ECB deal with the problem of bank stabilisation. It has thus not been possible to reduce the Target balances and replace them with measures that make public the liability and the extent of assistance. In addition, government securities of the GIPS states were purchased in violation of treaties and statutes in order to 'reassure' the markets and to avoid alleged defects of monetary policy. This was not about monetary policy in the strict sense but financial market stability and public finance. The interest rate differentials in the eurozone were natural reactions of the markets to mistakes and wrong political

[15] Here a monetary policy is assumed that results in no additional money creation in the deficit countries in comparison to the equilibrium situation.

[16] Through temporary assistance or permanent transfers of the other members of the monetary union, the lacking private capital imports can be replaced by public funds and so the balance of payments problem can be solved in the short term or permanently. The rescue packages now play this role.

[17] The graphs of Sinn and Wollmershäuser (2011, 40) suggest that in the case of Greece and Portugal, the Target balances primarily financed the current account deficits and for Ireland repatriation and capital flight, whereas in Spain private capital inflows were still able to finance in part the current account deficit.

[18] The amount of central-bank money flowing into the surplus countries was neutralised by counter operations there, so that no inflationary effect was touched off in the eurozone. This, however, limited the money creation possibilities there, *ceteris paribus*.

decisions in the affected countries and not defects of monetary policy. The real problems of the ECB's interventions were not solved but only postponed and ultimately made more expensive.

The politicization of the ECB

The monetary policy of the ECB is now far removed from the tradition of the old Bundesbank. The financing of balance of payment problems *via* money creation in exchange for inferior collateral[19] and the financing of sovereign debt through the purchase of securities on the market have little in common with traditional monetary policy. With its rescuing of banks and governments, the ECB, without a mandate, has communitarised national banks and sovereign risk at the expense of the ECB's owners and ultimately, their taxpayers, which is not the task the ECB has been given. The primary task of the ECB, namely, monetary policy, is becoming more and more subordinate to rescuing governments and banking systems and the financing of the external imbalances.

Also, the composition of the ECB's governing bodies does not correspond to this policy. If the ECB is less a monetary institution than a 'bad bank' of threatened national banking systems and a financier of national debt and balance of payments deficits, incurring considerable risks, an adjustment of the voting and distribution of influence of the capital and liability structures is absolutely necessary. Equal voting rights regardless of the size, economic weight and liability are only an invitation to wrong decisions. The moral-hazard problems are obvious!

The public dispute between ECB President Trichet and former Bundesbank President Weber on the purchase of government securities first focused attention on this issue. It is obvious that while the personal independence of the board members of the ECB is legally shored up to a large extent by treaties and statutes, it is hardly possibly to speak of political independence since at least the nationally appointed central bank presidents see themselves also as representing the interests of their regions[20] and since the ECB is very much involved in the decisions of EU and euro political bodies.

The ECB's expansion of the purchase programme to Italian and Spanish government bonds is for the moment the final act of a series of mistakes. The purchase is virtually an anticipation of the planned expansion of the powers of the EFSF, which will require the approval of the national parliaments. This has absolutely nothing to do with monetary policy, but is all about saving these countries high interest costs. Thus, the ECB has made itself into a handmaiden of fiscal-policy interests and a front for policy-makers. This is underscored by the implicit request of the French and German government immediately prior to the ECB decision.

The risks assumed by the ECB and the fear of revealing open losses, which would do additional damage to the public reputation of the ECB, also strongly influenced its conduct in the controversial issue of whether and to what extent a debt reduction should be made for Greece and whether the private banks should be protected in whole or in part from the necessary write-downs. The position taken by the ECB was interest-based and highly partisan. At all costs it sought to avoid write-offs and loss statements in its own balance sheet that would reveal the true extent of its involvement in the banking and government rescues. To this day the ECB is not willing to admit that it has participated comprehensively in the financing of balance of payments deficits and denies the problem of the Target balances.

The ECB is thus a prisoner of its own bad decisions and of the politicians that are seeking to rescue Europe, and thus it continues to suffer losses of independence, trust and reputation. For the politicians who opposed a strong and independent central bank and who only accepted this model in the Maastricht Treaty under pressure from Germany, this development is certainly not unwelcome. Especially with the difficulties in which the monetary union has fallen because of political mistakes and failures, a strong and independent central bank patterned after the Bundesbank[21] is necessary. Otherwise, the ECB's policies will continue to be derailed.

[19] Asset-backed securities, which played an inglorious role in the American banking crisis and which now have almost completely disappeared from the markets, are experiencing a renaissance in the euro area. They are deliberately created as a pledge for the ECB. Among other things, the claims from the loans for purchases of players for Spanish football clubs are to be financed *via* ECB securitisation.

[20] A publication of the minutes and the voting results of the ECB Governing Council is strongly recommended.

[21] However, this also entails a European public opinion that backs the ECB and that protects it from the attacks and impositions of policy-makers.

Consequences

To achieve this it is necessary that in future the ECB focus solely on actual monetary policy,[22] that it solves the problem of the Target balances, that it abandon its role as the saviour of governments and banks and that it rid its balance sheet of the various associated risks. Such a clear break is only possible with the help of the owners, who must assume the risks and losses incurred either *via* the Luxemburg fund or directly *via* the respective treasuries. That the national parliaments must be involved is obvious. In the past the ECB assumed risks without the consent of the national parliaments that will lead to losses that have to be borne by the taxpayer.

The solution for the Target problem is found in the American Federal Reserve System, as Sinn and Wollmershäuser (2011) point out, i.e. in the annual settlement of balances with assets between the participating central banks. This is feasible for the future new balances although very painful. The junkies in the deficit countries will be deprived of the drug of additional central bank money to finance their external imbalances.

The settlement of the accrued old balances will be much more difficult. At much more than roughly 450 billion euros[23] they are significantly higher than the funds that have been paid by the rescue schemes. Given this astronomical sum, a solution will probably only be possible *via* special measures, such as the inclusion in the rescue plans, if the mobilised assets of the NCBs (e.g. in Ireland) are not sufficient coverage, which cannot be ruled out.

This would once again increase the volume of these funds significantly, which is certainly not without problems but has the advantage that the debt problem as a whole would finally be exposed and a comprehensive solution must be sought. Only then can the fiscal competence of parliaments and public confidence be restored. A clear break and termination, with fear and trembling, is much better than the current never-ending fear and trembling. The fact that the hitherto unsolved problem of the treatment of the balances when a member leaves the monetary union is mentioned only in passing.

Such a turnaround will not be easy to achieve, since the previous beneficiaries of ECB policies will not give up their advantages, especially with the Target balances, without a fight. Germany, during the negotiations for the intrinsically useful Target system, apparently overlooked the abuse possibilities and dangers. On the other hand, Germany as a potential surplus and creditor country in a monetary union cannot accept that such a cheap and automatic way to finance balance of payments deficits continues to its detriment. Otherwise the external imbalances are likely to perpetuate and the collapse of the monetary union is pre-programmed. An improperly designed and managed European Monetary Union does not promote the European idea and further integration but endangers or destroys it. The sooner German policy-makers recognize these problems and act, the greater are the chances of success. This, however, requires knowledge, courage and negotiating skills. Wishful thinking and a falsely understood European solidarity will only extend and further exacerbate the problems. They are the real threat to the euro and Europe!

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[22] The return to a normal monetary policy also requires that the ECB and the implementing NCBs again pay strict regard to the creditworthiness of the submitted collateral and that the emergency measures that lead to an expansion of the money supply, such as the Emergency Liquidity Assistance, be avoided. The extremely high negative Target balances in comparison to GDP show that these have been used to finance the capital withdrawal and capital flight from the completely oversized Irish banking system. Instead of private depositors, the ECB/NCBs have become by far the largest creditors of Irish banks and thus indirectly bear the immense risks of the financing of the real-estate bubble.

[23] Bundesbank's Target balance as of 30 September 2011 (see http://www.bundesbank.de/statistik/statistik_zeitreihen.en.php?func=row&tr=EU8148). The huge increase is due to the fact that the Italian central bank has run a massive Target deficit for the first time. Thereby capital flight and repatriation from Italy are probably financed.