THE EURO-CRISIS & THE MATHEO SOLUTION (TMS)

Angela Merkel (2012): "…wir brauchen sicherlich auch 'Mechanismen' in der Eurozone, wie wir Ländern, deren Wettbewerbsfähigkeit noch nicht ausreicht, helfen können, wie wir sie unterstützen können…"

Dipl. Ing and LL.M. André ten Dam
independent Euro-researcher

Übersicht:
Im folgenden Beitrag wird ein angepasstes Euro-Modell vorgestellt: der Euro-Währungseinheiten Wechselkursmechanismus (ECU-ERM). Das Modell beruht auf der Trennung von Währungseinheits- und Zahlungsmittelfunktion des Geldes. So bleibt der Euro als Währungseinheit (ECU) und als einziges gesetzliches Zahlungsmittel in der Eurozone bestehen, während neben dem ECU nationale Währungseinheiten (NCU's) eingeführt werden. Diese NCU's dienen als nationale Abrechnungseinheit für Preise und Löhne, und können gegenüber dem ECU fluktuieren, wodurch eine Anpassung zwischen den divergenten Euro-Ländern direkt ermöglicht wird. Der Autor vergleicht den ECU-ERM mit anderen Ausgestaltungsmöglichkeiten und stellt sowohl die Vor- als auch die Nachteile heraus. Zudem wird diskutiert, warum jeder Euro-Rettungsmechanismus umfassend und weitreichend gestaltet sein sollte.

I. Introduction and summary

The Euro-crisis painfully shows us that the present Euro zone is not an optimal single currency area for participating economical divergent sovereign states. The primary flaw of the present 'One-Size-Fits-All' Euro Pact is that it lacks a *'flexible monetary mechanism'*, which can repair developing macro-economic imbalances (especially in the international production price levels) between the Euro-countries and other national harmful economic issues, *at any given moment* and *in a simple way*.

The consequences have been that, after the introduction of the euro and EMU, the weaker Euro-countries increasingly lost their competitiveness (France, Italy, Spain, Portugal and Greece vis-à-vis Germany with 15% to 30%) and therefore their perspectives of sound real economic growth. Several Euro-countries also experienced overheating economies (first in the Netherlands and later in Ireland and Spain), with inflationary pressures and real-estate bubbles which could not be combated anymore by raising the respective national interest rates.

The economies of the weaker countries have now collapsed and state finances have become unsustainable. Private banks which financed those economies and states are logically facing insolvency as well, and therefore the stability of the financial system is in great danger. The irony, or better said the tragedy, is that because of the given financial support and the decreasing exports to the weaker countries, the initially stronger countries are drawn into the misery as well. And the continuing Euro-crisis has affected all other global economies.

Because the Euro zone's national and supra-national political and monetary authorities proclaim that 'Europe' is our future, they state that the Euro should be irreversible. Their strategies to tackle the main cause of the Euro-crisis therefore involve 'reforms' and 'austerity'. With taxpayers' money and guarantees by the stronger countries, European politicians and the ECB try to combat the symptoms of the crisis. But as economic reforms are not enough, the complementary strategy is to restore the national competitiveness of the problem countries by means of 'internal' devaluations (reduction of real prices and wages in the private sector).

However, after more than two years of struggling, we all must conclude that 'internal' devaluation is a very long and painful process,

which destroys the respective national economies and which result in mass unemployment, severe poverty, social unrest and political instability. So a change in policy towards the much more effective 'monetary' devaluation strategy is urgently needed. Only then (international) investors will start to move towards the weaker countries, facilitating the recovery of the economies and state finances in these countries …on the necessary short notice.

In this article I will argue that 'monetary' devaluation on a national level is possible within a slightly adapted Euro Pact. Therefore I will explain the innovative but simple *'Euro Currency Units-Exchange Rate Mechanism (ECU-ERM)'*, which converts the Euro Pact into a *'flexible'* Pact, which makes it suitable for the divergent Euro zone. After having done this, I will explain why the ECU-ERM should be preferred above other effective 'monetary' devaluation concepts, such as proposed by *Thomas Mayer* (the *'Geuro'* as a parallel currency for Greece, 2012) and by *Hans-Werner Sinn* (temporarily *'Euro Holiday'* for Greece and other weaker Euro countries, 2012). Then I will argue that any Euro rescue proposal (no matter which) should be comprehensive. Finally I will conclude that a full political and fiscal union is neither necessary nor desirable for a proper functioning Euro and EMU, and that the combination of *'The Matheo Solution (TMS)'* (including the ECU-ERM) with an adapted *Euro Money System (Target 2)* is the best approach to tackle the Euro-crisis.

II. The ECU-ERM versus the 'Geuro' and 'Euro Holiday' proposals

The ECU-ERM is a new and innovative variant of the existing general 'Parallel Currency' concept. It was first presented in 2010 as the core-concept of *'The Matheo Solution (TMS)'*. On the initiative of *Hans-Werner Sinn*, TMS was first brought into the scientific economic debate by the *Ifo Institute* (2011). And on the initiative of *Mario Ohoven* and *Michael Vogelsang*, TMS has now been brought into the public and political debate by the BVMW (2012).

In its first element, the ECU-ERM distinguishes the Euro as *the only legal tender* (means of payment: banknotes, coins and electronic transfers) in all Euro-countries from the Euro as a *numéraire* (currency-unit) for the calculation of prices and wages. This presents the opportunity to introduce National Currency-Units (NCU's) in all individual Euro-countries which will serve *alongside* the already existing (but in the EU-Treaty not yet as such defined) Euro Currency-Unit (ECU). More or less similar to the former ERM, the NCU's of the economical weaker countries can then fluctuate (devalue) against the NCU's of the stronger countries. Adjustment of a NCU in a country means adjustment of the individual national levels of prices and wages compared to these in the other countries. In accordance with the required adjustments their international competitiveness will then be *instantly* restored, with direct perspectives of future sustainable sound real economic growth.

All things considered (mainly because the Euro should be a strong international currency and not a 'weichwährung'), the value of the Euro Currency-Unit (ECU) should be equal and pegged to the NCU of the economically strongest Euro country. To prevent capital flights and chaos, and to avoid legal complications, all the *existing* national and international debits/credits nominated in Euro will remain nominated in Euro/ECU. *New* national debit/credit transactions will be nominated in the respective NCU. And new international debit/credit transactions will continue to be nominated in Euro/ECU.

When designing this element of the ECU-ERM, I was obviously inspired by the monetary situation in the Euro zone between 1999 and 2002. In that 'mirror situation' there were many national currencies (legal tenders as well as currency-units) with one common (parallel) euro currency-unit.

The second element of the ECU-ERM is the urgently needed re-introduction of *interest-rate differentiation* at national (NCU) levels, alongside an interest-rate for the Euro/ECU, which makes it possible again to stimulate or cool down individual national economies when necessary, and to combat unsustainable national inflation.

The ECU-ERM and the money supply are managed by the ECB (in consultation with the respective national central banks), on the basis of objective economic fundamentals and according to the existing only monetary Treaty-policy concerning 'Sustainable Price Stability'.

Compared to the 'Geuro' proposal (and other *regular* parallel currency concepts) and to the 'Euro-Holiday' concept, the ECU-ERM in my opinion has the following 9 advantages:

- With the implementation of the ECU-ERM there will be no 'second rate' Euro (zone) member states. So there will be no division in the Euro zone of any kind.
- Let's Keep It Simple (KIS). For the implementation of the ECU-ERM, there is no need for new physical national coins and banknotes. After a simple adaptation of the relevant software systems of the monetary authorities and financial markets, the ECU-ERM could be introduced on a very short notice.
- For the implementation of the ECU-ERM, an EU-Treaty change is not needed. In full compliance with article 128 TFEU, the ECB-issued Euro remains the only legal tender in all Euro countries.
- 'Gresham' (bad money drives out good money) is not applicable to the ECU-ERM. So there will be no 'currency competition' of any kind.
- The ECU-ERM is managed by the independent ECB, on the basis of objective economic fundamentals. Thus there will be no unfair (overshooting) devaluations. And the necessary ECU-ERM devaluations will therefore also be immune for (national) political pressures.
- When the ECB executes its new tasks properly and promptly, there will be no 'currency speculation'.
- Compared to the 'Euro Holiday' concept, with the implementation of the ECU-ERM (or the 'Geuro' concept), there will be no capital flights.
- Because not a national authority but the ECB controls the money supply, 'sustainable price stability' is guaranteed in every Euro country.
- 'Last but not least' the ECU-ERM will be integrated *within* the Euro Pact. So there will be no competitive/hostile monetary system alongside the Euro Pact. Thus the ECU-ERM should be acceptable for the Euro zone (monetary) authorities and pro-Euro politicians.

When implementing the ECU-ERM, the authorities should obviously explain to the people in the devaluing Euro-countries that – except for the *existing* debits/credits – the consequences of NCU devaluation is no different than the consequences of a 'regular' monetary devaluation of a national currency. Double pricing (in NCU and in Euro/ECU) in shops and other businesses would be necessary for a smooth implementation and a successful execution of the ECU-ERM.

III. The necessity of a comprehensive approach to tackle the Euro-crisis

Thus any solution proposed to tackle the Euro-crisis (no matter which) has to start with an element that *instantly* repairs the international price/wage-competitiveness in the weaker Euro countries. However that is not enough. Any solution proposed to tackle the Euro-crisis (no matter which) has to be *comprehensive* as well. Within the EU-Treaty legal and economic framework of 'No bail out' and 'Sustainable price stability', The Matheo Solution (TMS) therefore concentrates on realizing 3 objectives:

a. Sustainable sound real economic growth, in all Euro countries

To fulfil this objective, implementation of the ECU-ERM and economic reforms (especially in the weaker countries) are urgently needed. Moreover, within the Euro zone, production should be diversified using the natural, geographical, climatological and innovative comparative advantages of each country. The European Investment Bank (EIB) could be a guide and initiator in these diversification processes.

b. Solid and sustainable state finances in all Euro countries

Because 'if you cannot pay your debts, you will not pay your debts', TMS further involves the reduction of the national State debts of the insolvent countries to a sustainable level by means of an 'IMF Insolvency Pact'. This Pact involves 'Controlled defaults' of sovereign Euro countries, including 'Clean haircuts' of State bond holders, under the auspices of only the IMF. And only the IMF will lead the implementation of the necessary economic reforms and arrange temporary emergency loans. *Carmen Reinhart & Kenneth Rogoff* (2008) will help us to answer the question: 'What is the maximum level of a State debt of a country for sustainable sound real economic growth?' TMS also involves proposals to strengthen the Stability and Growth Pact (SGP).

c. A solid and stable financial system in the Euro zone

TMS proposes an 'ECB Safety-Net' for European (system) banks that will experience liquidity and capital problems. Liquidity support has already been executed in some (wrong and overkill) form by the LTRO's of the ECB. For the required recapitalization, TMS offers a 3-step approach: First aim to attract private capital. If that is insufficient, then consider (partial) nationalisation. And if that provides insufficient perspective, TMS proposes an *innovative* European concept to rescue troubled *system* banks. For this purpose the 'European Bank for Bank Capital Support (EBBCS)' should be established. It is effectively a capital support fund, which is to be financed by the ECB (ECB = 'The Lender of Last Resort' with unlimited means) and which secures the stability of the Euro zone financial system. The EBBCS provides capital to troubled banks, in exchange for shares. These shares will serve as collateral to the ECB. Because these finances are only used for capital support, there will not be an inflationary effect. As soon as these banks have recovered and can obtain sufficient capital normally, the temporary capital support will flow back to the EBBCS. And the EBBCS will repay the ECB-loans.

Thomas Mayer (2012) also proposed such a concept and called it a 'Bank Union'. The main differences are that the EBBCS is financed by the ECB, while Mayer's 'Bank Union' is financed by the EFSF/ESM, and that the EBBCS is restricted to *system* banks. Thus the EBBCS saves taxpayers' money. And an interesting question is, if providing the ESM with a bank-license (for the necessary sufficient fire power) is in compliance with German Constitutional Law?

Also important is that TMS cancels the need for Eurobonds. The EFSF and the permanent ESM will not be needed. The ECB purchase of State bonds of the weaker Euro countries can be terminated.

Interestingly, *Harry Geels* (2012) recently judged an ranked – according to *'The Euro Solution Matrix'*[1] – the 'Geuro' plan and the 'Euro Holiday' concept among the better and 'The Matheo Solution (TMS)' as the best of all available approaches to tackle the Euro-crisis …simply because with these 3 strategies, the economies of the weaker Euro countries will have the best perspective to recover instantly.

However, also TMS is not enough. Because besides addressing the abovementioned 3 objectives, the Euro zone also needs a properly designed and functioning Euro Money System (Target 2), with a regular annual settlement of the developed debit/credit positions between the participating members. Concerning this we all should listen to Hans-Werner Sinn (2011)! And another interesting question is, if the present voting system of '1 country (national central bank), 1 vote' within the ECB-board decision-making-process is reasonable, workable and sustainable?

IV. Conclusions and recommendation

'The Matheo Solution (TMS)' will provide to *all* Euro countries sufficient *flexibility* to react to developing com-

1 'The Euro Solution Matrix' (2012) is an innovative, simple and highly effective tool to properly analyze the problems of the Euro-crisis, and to judge and rank (on the basis of objective relevant criteria) the available proposals to tackle it. See: http://www.inmaxxa.nl/resources/site1/General/Euro%20Solution%20Matrix%20v23_7_2012%20Inmaxxa.pdf

petitive imbalances (adjustment), so that major national recessions can be avoided and all Euro countries may prosper. Instead of being a burden, the euro will become an asset. And the threats of a permanent 'Transfer Union' or 'a Break-Up scenario' will be averted. At the same time TMS will turn the Euro into a reliable, stable, strong and lasting international currency.

For a summary of all the proposals of TMS see the attached *Appendix*.

All things considered, a full Euro zone political and fiscal union is neither necessary nor effective to let the Euro (zone) and EMU survive and function properly. The *flexible* 'ECU-ERM' concept, an 'IMF Insolvency Pact' (for insolvent countries), the reinforcement of the SGP (in accordance with original intentions of the Maastricht Treaty), a restricted ECB-financed 'Bank Union' (for the recapitalization of system banks) and an adapted Target 2 system *can* and *should* do the job!

Appendix

'The Matheo Solution (TMS)' (2010) in full:

1. Implementation of the ECB-managed ECU-ERM (Currency Innovation). Monetary devaluations in the problem countries on the basis of the 'economic fundamentals' (such as PPP's). To prevent capital flights and for legal reasons existing national and international debits/credits remain nominated in Euro/Euro Currency-Unit. New national debit/credit transactions will be nominated in the respective NCU. And new international debit/credit transactions will continue to be nominated in Euro/ECU. Interest rate differentiation on a national level.

2. The national economies of troubled countries should be reformed under the supervision of the IMF (possibly in conjunction with the World Bank). Investment programs should be financed by (international) private parties and the European Investment Bank (EIB).

3. Under the supervision of the IMF, the unsustainable national State debts of the problem countries should be reduced to sustainable levels by means of 'clean hair-cuts' ('IMF Insolvency Pact' with 'Controlled Defaults'). Emergency loans to problem countries will only be made by the IMF (with the financial support of non-euro zone countries).

4. The ECB continues to control the monetary policy of the Euro zone and determines and regulates the money supply according to the existing only Treaty norm concerning 'Sustainable Price Stability'. Unsustainable private debts in the problem countries also have to be reduced to sustainable levels.

5. Strengthening of the SGP ('debt-brake' and creation of crisis buffers) and its re-enforcement (ultimum remedium: expulsion from the Euro zone, without necessarily having to leave the EU).

6. The introduction of 'voluntary exit' ('Opt-out'), without necessarily leaving the European Union (EU) and therefore without rejection of (the rest of) the EU-Treaty, for Euro-countries that can not or will not comply to the Euro Pact rules concerning State debts, State budgets, Sustainable price stability (combating inflation) and economic performance.

7. The 'No-bail-out' clauses have to be maintained and - if necessary - strengthened. Euro-bonds will not be permitted.

8. Establishment of an 'ECB Safety-Net' for European (system) banks that will experience liquidity and capital problems. Liquidity support only to private banks which need liquidity and offer solid collateral. For the required recapitalization, a 3-step approach: First aim to attract private capital. If that is unavailable then consider (partial) nationalisation. And if that provides insufficient perspective a capital safety-net to rescue troubled system banks. For this purpose the 'European Bank for Bank Capital Support (EBBCS)' should be established. It is effectively a capital support fund, which is to be financed by the ECB (ECB =

'The Lender of Last Resort' with unlimited means) and which secures the stability of the Euro zone financial system. The EBBCS provides capital to troubled banks, in exchange for shares. These shares will serve as collateral to the ECB. Because these finances are only used for capital support, there will not be an inflationary effect. As soon as these banks have recovered and can obtain sufficient capital normally, the temporary capital support will flow back to the EBBCS. And the EBBCS will repay the ECB loans.

9. Restructuring of the banking sector, in the sense that banks should serve the interests of citizens, enterprises, and governments. Risky 'Investment-banking' must be separated from the regular (public) banking functions. Exorbitant earnings, including the ridiculous 'bonus culture' causing the damaging focus on short-term profitability should be terminated. Strengthened Bank supervision by the EBA (in consultation with the ECB and the national central banks of the non-Euro EU countries).

10. The immediate end to the European financial support for countries, and – via countries – for banks in trouble. An immediate end to the 'ECB purchases' of State bonds.

Reference list

BVMW (2012), Lösungen statt Populismus, BVMW.de, 30. Juli 2012. http://www.bvmw.de/nc/homeseiten/news/artikel/loesungen-statt-populismus.html

Dam, André ten (2012), A short Introduction to 'The Matheo Solution (TMS)', Incassomeesters.nl, 7. February 2012. http://www.incassomeesters.nl/the-matheo-solution-a-short-introduction-07-02-2012.pdf

Geels, Harry (2012), The Euro Solution Matrix: Ranking the euro rescue proposals, Inmaxxa.nl, 5. Juli 2012. http://www.inmaxxa.nl/columns/the-euro-solutions-matrix-ranking-the-eurorescue-proposals.aspx

Ifo Institut (2011), Zur Diskussion gestellt – Eurokrise: Ist eine tempörare Einführung einer Parallelwährung in den Krisenstaten eine Lösung?, ifo Schnelldienst, 64. Jg., H. 23, S. 12-25. http://www.cesifo-group.de/ifoHome/publications/docbase/details.html?docId=17206079

Mayer, Thomas (2012), Der Geuro – Eine Parallelwährung für Griechenland?, DB Research, 23. Mai 2012. http://www.dbresearch.de/PROD/DBR_INTERNET_DE-PROD/PROD0000000000288868/Der+Geuro%3A+Eine+Parallelw%C3%A4hrung+f%C3%BCr+Griechenland%3F.pdf

Merkel, Angela (2012), Pressekonferenz von Bundeskanzlerin Merkel zu aktuellen Themen der Innen- und Außenpolitik, Mitschrift Bundesregierung.de, 17. September 2012, Berlin. http://www.bundesregierung.de/Content/DE/Mitschrift/Pressekonferenzen/2012/09/2012-09-17-pk-merkel-bpk.html

Ohoven, Mario (2012), Lieber Parallelwährung als Vergemeinschaftung, Financial Times Deutschland, 28. Juni 2012. http://cms.ohoven.de/file/29120628_ohoven_komm_ftd.jpg

Reinhart, Carmen and Kenneth Rogoff (2008), The Forgotten History of Domestic Debt, Working Paper of the National bureau of Economic research, NBER No. 13946. http://www.nber.org/papers/w13946.pdf

Sinn, Hans-Werner und Timo Wollmershäuser (2011), Target-Kredite, Leistungsbilanzsalden und Kapitalverkehr: Der Rettungschirm der EZB, ifo Schnelldienst, Sonderausgabe Juni 2011. http://www.cesifo-group.de/portal/pls/portal/docs/1/1206574.PDF

Sinn, Hans-Werner and Friedrich Sell (2012), Our opt-in opt-out solution for the euro, Financial Times, 31. Juli 2012.

Vogelsang, Michael (2012), Die temporäre Doppelwährung als Kompromiss zwischen Deflationsstrategie und Austritt aus der Europäischen Währungsunion, Zeitschrift für Wirtschaftspolitik, 61. Jg., Heft 1, S. 69-81.

Links last accessed on November 07, 2012