Rising Tide of *German Anger*

By Klaus C. Engelen

Fierce opposition threatens the eurozone's ECB bank supervision and debt mutualization scheme. Can Merkel politically survive?

From a German perspective, the battle over EU banking union will be heating up during the months stretching into next year's national election campaign, when the coalition government of Angela Merkel, sometime in September 2013, will face deeply worried voters. "If you tell German voters that they should support a pan-European deposit scheme with their savings, you surely will lose the election," predicts a pollster, who notes that 84 percent of Germans expect a worsening of the euro crisis and fear future losses due to the eurozone turbulence. As the opposition Social Democrats and Greens begin positioning themselves for next year's elections, the Berlin government's maneuvering room to come up with more bailout money and direct bank recapitalization for countries such as Spain is shrinking. Now that former Finance Minister Peer Steinbrück—who proposed radical financial reforms—has been designated as the SPD candidate for the chancellor's office, Merkel will meet an experienced financial crisis manager as challenger.

But for the millions of citizens in debt-stricken eurozone countries suffering under never-ending austerity programs, it sounded too good to be true when in the waning hours of June 28, at their summit in Brussels, the leaders of the seventeen

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THE INTERNATIONAL ECONOMY

THE MAGAZINE OF INTERNATIONAL ECONOMIC POLICY

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member states that form the European Monetary Union unexpectedly agreed to establish a European banking union—and do it in a rush. In a first unexpected step, a pan-European single supervisory mechanism would be set up at the European Central Bank under which all six thousand banks in the eurozone would be supervised. As soon as this supranational supervision regime becomes operational in Frankfurt where the European Central Bank is located, the European Stability Mechanism would be in a position to lend directly to banks, which so far has not been possible.

Financial markets reacted with euphoria because this would open the way to direct bank recapitalization in Spain and other strained member states. Aiming at implementing a single rulebook for the European Union, the eurozone leaders committed themselves not only to establishing supranational supervision, but also to working on a pan-European resolution regime and fund and more harmonized deposit guarantee schemes.

And what some call the "SSM monster"—pushed by the Brussels bureaucracy, the ECB establishment, and Europe's parliamentarians with zealousness—is rolling forward. At their last EU summit on October 19 in Brussels, European leaders moved further toward ECB-led bank supervision by committing to seek to agree on a legal framework by January 1, 2013. And draft banking legislation tabled in the Economic and Monetary Affairs Committee of the European Parliament already is being discussed by journalists. The ECB signals that "several task forces are working on various issues of the European banking union."

To understand what happened from a German perspective, it is crucial to look at the paragraph on financial supervision in the June summit communiqué: "We affirm that it is imperative to break the vicious cycle between banks and sovereigns. The Commission will present Proposals on the basis of Article 127 (6) for a single supervisory mechanism shortly. We ask the Council to consider these Proposals as a matter of urgency by the end of 2012. When an effective single supervisory mechanism is established, involving the ECB, for banks in the euro area the ESM could, following a regular decision, have the possibility to recapitalize banks directly. This would rely on appropriate conditionality, including compliance with state aid rules, which could be institution-specific, sector-specific, or economy-wide and would be formalized in a Memorandum of Understanding."

The ECB was more villain than savior when it comes to the survival of monetary union.

For some Merkel watchers, her consenting to this paragraph at the June EU summit may turn out to be the biggest political blunder of her illustrious career. Addressing Berlin lawmakers on the eve of the summit, Merkel not only made her famous statement rejecting eurobonds "as long as I live," but also asserted again that "the euro rescue funds will only lend to governments and not directly to banks that need recapitalization."

Returning from Brussels afterwards—in the perception of everyone reading the summit news—she was blackmailed into opening the door to EU banking union in order to use the euro rescue funds for a €100 billion Spanish bank recapitalization program, supervised under EFSF/ESM guidelines and an EU surveillance. Merkel met fierce condemnation at home. Observers saw a stunning—for some unbelievable—reversal of a long-held German position.

Merkel's Waterloo at the Brussels summit deepened the sinking feeling of millions of German savers and taxpayers. More Germans become convinced that the European Central Bank as lead bank

ARMIN KÜBELBECK

Merkel's Greatest Blunder?

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Head of the ECB "Mega Bad Bank"

ECB President Mario Draghi is seen, as he works closely with the leaders of Italy, Spain, and France, as the key mover and shaker in this power grab for an ECB-led pan-European single supervisory system. He will get—by a highly questionable political compromise and on a questionable legal basis—supranational control powers beyond what the founders of monetary union ever intended.

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supervisor, under former Italian central bank Governor Mario Draghi, will get an even bigger role in facilitating the transfer of wealth from Germany and other northern Eurozone countries into the debt-laden euro member states.

EU LEADERS' CREDIBILITY AT STAKE

Beyond deepening worries in Germany and other northern eurozone countries as they watch the ECB evolving into Europe's "mega bad bank," the EU summit decision at the end of June to suddenly transfer bank supervision to the ECB in order to facilitate direct bank recapitalization has confidence-shattering implications.

This development deepens the divisions in the European Union, since London, the largest European financial center, will be left out. This means putting the ten EU members outside the seventeen-member eurozone into bank supervision limbo, since the role of the present banking watchdog, the European Banking Authority, which became operational in January 2011 and is headquartered in London, is put in doubt. Loading the crisis-stressed ECB with the additional task of becoming lead banking supervisor in the first phase of a more integrated EU banking union opens a Pandora's box in terms of conflict of interest, transparency issues, litigation risks, and—last but not least—mind-boggling democratic legitimacy problems. The EU leaders have changed the rules and the power equation in the eurozone and the wider European Union, with the financially strong countries such as Germany left holding the short end of the stick.

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After breaking the no-bailout rule by setting up a temporary European rescue fund in response to the Greek insolvency in the spring of 2010, EU leaders are again ready to break the European Treaty in a major way.

It is stunning that they are prepared to entrust such a huge task to an ECB supranational apparatus. In its first decade of existence, the ECB might have preserved a good measure of price stability, but on the way may also have wrecked European monetary union in another way. It clung to an unrealistic notion of a monetary area where large imbalances were sustainable and country risks—despite an unsustainable external private and public debt buildup—could be neglected. In this way, the ECB was part of the monumental governance failure of other EU institutions such as the EU Council and the EU Commission. The ECB was more villain than savior when it comes to the survival of monetary union. Looking for help to an EU institution with no record in either macro-prudential or micro-prudential performance before or after the financial crisis may result in one more systemic risk for the eurozone.

If the ECB is entrusted with the pan-European bank supervisory mandate, this could further worsen its already low level of citizen trust. And there are several areas where not only the ECB establishment but also the EU Council and the European Commission have a lot of explaining to do.

Merkel was blackmailed into opening the door to EU banking union in order to use the euro rescue funds for a €100 billion Spanish bank recapitalization program.

First, why did EU leaders and the EU Commission totally ignore the expert advice given in the mandated Larosière report not to transfer bank supervision to the ECB? How can EU policymakers be trusted by the citizens and market participants if they embark on probably the most radical change in Europe's financial supervision framework at one Brussels summit while totally ignoring—and not even discussing—the advice of independent high-level experts they themselves mandated to come up with reform options? Why didn't the European Parliament or the European media raise this issue?

The largest national financial system in the eurozone would be forced under an ECB supervision structure to be controlled under a "one country, one vote" scheme.

Second, how could EU leaders use Article 127 (6) of the Treaty on European Union in full knowledge that it was not intended as a legal basis for the transfer of banking supervision to the ECB? How can EU leaders with legions of lawyers ignore how their mega-project of a pan-European banking union with a single supervisor at its core to oversee all six thousand eurozone banks would be operating on shaky legal ground?

Third, how can EU leaders and the European Commission commit to a Europe-wide change from seventeen national banking authorities and a recently established EU-wide European System of Financial Supervisors into one supranational body in just a few months and retain a measure of credibility *vis-à-vis* their citizens and market actors? How can such a system become operational with other important components of banking union such as a bank resolution system and a deposit guaranty scheme when there is no common consensus among the member states? How do those who have embarked on transferring supervision to the ECB make sure that the existing bank supervision authorities remain effective during the transition phase?

IGNORING THE ADVICE OF THEIR OWN EXPERTS

Looking back at the evolution of coordinated financial market supervision in the European Union, one might start with the work more than a decade ago of Baron Alexandre Lamfalussy and his "Committee of Wise Men on the Regulation of European Securities Markets," charged with the task of recommending changes in the legislative process in order to integrate the EU securities markets.

It took until January 2011 for the present institutional architecture of the EU's framework for financial supervision, the European System of Financial Supervisors, to become operational in response to the financial crisis. Proposed by the European Commission in 2009, it replaced three existing Committees of Supervisors with three new authorities, called European Supervisory Authorities: the European Banking Authority, the European Insurance and Occupational Pensions Authority, and the European Securities and Markets Agency. The framework was complemented with the European Systemic Risk Board under the responsibility of the ECB.

In October 2008, EU President José Manuel Barroso gave a mandate to Jacques de Larosière, former Banque de France governor and managing director of the International Monetary Fund, to put together a "High-Level Group on Financial Supervision in the EU." Outstanding experts such as Leszek Balcerowicz, Otmar Issing, Rainer Masera, Callum McCarthy, Lars Nyberg, José Pérez, and Onno Ruding worked on the study. David Wright, then deputy director-general of Internal Market and Services at the European Commission, was the rapporteur. When the report was presented in February 2009, the high-level experts received praise in Brussels and other eurozone capitals.

To put the Larosière report in perspective, it was similar to the Financial Crisis Inquiry Commission study in the United States of the causes of the 2007–2010 financial crisis that was used as the basis for the Dodd-Frank financial regulatory reform, or the Independent Commission on Banking under Sir John Vickers that came up with the recommendations for the overhaul of the British financial market supervision structure. In that respect, the Larosière report was the only major expert study mandated by the EU Commission to come up with recommendations to adjust the pan-European framework of financial supervision to the lessons of the financial crisis.

The study's authors took a strong position against transferring bank supervision to the ECB, which may explain why Council President Herman Van Rompuy, EU President Barroso, Eurogroup President Jean-Claude Juncker, and all sixteen heads of state chose to ignore the advice of those experts who had been mandated with coming up with EU financial supervision reform proposals.

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Discussing the role of the ECB, the experts concluded: "While the Group supports an extended role for the ECB in macro-prudential oversight, it does not support any role for the ECB for micro-prudential supervision. The main reasons are:

- The ECB is primarily responsible for monetary stability. Adding micro-supervisory duties could impinge on its fundamental mandate;
- In case of crisis, the supervisor will be heavily involved with the providers of financial support (typically ministries of finance) given the likelihood that taxpayers' money may be called upon. This could result in political pressure and interference, thereby jeopardizing the ECB's independence;
- Giving a micro-prudential role to the ECB would be extremely complex because in a crisis the ECB would have to deal with a multiplicity of member states' treasuries and supervisors;
- Conferring micro-prudential duties on the ECB would be particularly difficult given the fact that a number of ECB/ESCB members have no competence in terms of supervision;
- Conferring responsibilities on the ECB/Eurosystem, which is not responsible for the monetary policy of a number of European countries, would not resolve the issue of the need for a comprehensive, integrated system of supervision;
- Finally, the ECB is not entitled by the Treaty to deal with insurance companies. In a financial sector where transactions in banking and insurance activities can have very comparable economic effects, a system of micro-prudential supervision which was excluded from considering insurance activities would run severe risks of fragmented supervision."

For all these reasons, the Larosière group felt the ECB should not become responsible for the supervision of financial institutions. However, the group considered that the ECB should be tasked with the role of ensuring adequate macro-prudential supervision in the EU.

There are worries about the potential conflicts of interest that could arise if the ECB is made responsible for bank supervision as well as monetary policy.

Ignoring—and not even discussing—these well-reasoned recommendations illuminates the measure of short-term expediency and the callous disregard for expert advice that has been a hallmark of EU crisis management at the highest level since the Greek sovereign debt crisis exploded in April 2010.

As to the legal basis of the EU proposals, this will not boost citizen trust in either European Union or ECB. The banking union "breakthrough" is hitting the Euroland public like boomerang.

A SHAKY LEGAL BASIS

Referring to legal experts, Werner Langen, a leading member of the European Parliament from the conservative CDU, questions the validity of Article 127 (6) as legal basis for the single supervisory mechanism. This reads, "The Council, acting by means of regulations in accordance with a special legislative procedure, may unanimously, and after consulting the European Parliament and the European Central Bank, confer specific tasks upon the European Central Bank concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings."

Says Langen, "If the architects of the Maastricht Treaty had wanted to transfer bank supervision to the ECB, they would have written this clearly in the Treaty, which they did not." In a special legal note, the Bundestag's Research Service came to the conclusion that the single supervisory mechanism plan would have to pass through the German legislature.

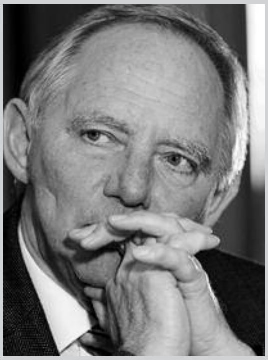
Even the EU Council's lawyers have serious doubts. As the *Financial Times* reported in its October 18, 2012, issue under the headline "ECB supervisory proposal illegal, says adviser," a paper from the EU Council's top legal adviser argued that the plan to put the ECB in the position of lead supervisor for the euro area's six thousand banks goes "beyond the powers" permitted under the law to change governance rules at the European Central Bank. The legal service of the EU Council concluded that "without altering EU treaties it would be impossible to give a bank supervision board within the ECB any formal decision-making powers, as suggested in the blueprint drawn up by the European Commission." The EU Council's legal service also came to the conclusion that "those non-eurozone countries that want to opt into the bank supervision regime would also be legally unable to vote on any ECB decisions—a key demand of countries as Sweden or Poland."

But from a German perspective, the EU Council legal opinion opens a threatening prospect: That Germany, in

Even Schäuble Has His Doubts

On taking office as finance minister in October 2009, reforming German bank supervision was high on Wolfgang Schäuble's coalition agenda. "Tear down BaFin" was the coalition's battle cry. BaFin, the Federal Financial Supervisory Authority, was framed as being responsible for the mega-failures leading up the Germany's banking meltdown. But as it turned out, the Merkel coalition's plans to turn the Bundesbank into Germany's lead supervisor, taking away staff and responsibilities from BaFin, failed spectacularly. The Bundesbank was not ready to give away an inch of independence in conducting monetary policy.

This past experience might lead to the question: If Germany was not able to transfer bank supervision to its national central bank, how could the seventeen-nation eurozone achieve such an institutional change in one big single supervisory mechanism miracle stroke? Schäuble may now be more Saul than Paul in believing in a EU banking union.



Wolfgang Schäuble,
Germany's finance minister.

Before departing for the IMF-World Bank annual meetings in Tokyo, at the EU finance ministers meeting in Luxembourg, Schäuble, in effect, went so far as to demand from Internal Market Commissioner Michel Barnier to go back to the drawing board on the single supervisory mechanism, dismissing key elements of the EU Commission proposals, as reported by news agency DAPD. He called the Brussels single pan-European banking union plans "anything but thought through." As he explained to journalists, many of his finance minister colleagues were realizing that the single supervisory mechanism does not offer solutions to the problems that have to be solved. Schäuble expressed fundamental doubts on transferring banking supervision to the ECB because of the "inherent conflicts of interests with the central bank's monetary policy task and the lack of parliamentary legitimation for becoming a banking supervisor." According to Schäuble, the EU Commission that has the "initiative monopoly" is now examining whether the ECB should assume EU bank supervision or "should play an essential role." And Schäuble warns: "Whoever wants to establish supervision in a hurry, has to solve the problems." Schäuble rejected getting boxed into a time frame, retorting, "Quality goes for unrealistic notions about time schedule."

—K. Engelen

terms of bank assets and liabilities by far the largest national financial system in the eurozone, would be forced under an ECB supervision structure to be controlled under a "one country, one vote" scheme. Since the supervision mandate over banks and other financial institutions involves to a large extent fiscal decisions—at a country's taxpayers' expense—and national wealth decisions of unforeseen dimensions, Germany would give such controls to an EU institution where the representatives of Malta, Cyprus, Luxembourg, or the debt-stricken Club Med countries would make fiscal and bank asset decisions that could have a destructive impact on the three-pillar German banking structure, its high-saving public, and its taxpayers. A similar loss has already happened in the area of the ECB's monetary policy, where the Bundesbank's member was voted down on the ECB Governing Council on the critical issue of buying the sovereign bonds of debt-laden eurozone members. Germany, the strongest financial power in the euro area, is becoming marginalized.

MISSION IMPOSSIBLE

"This epochal change for a large economic area is being undertaken on the fly, without any impact assessment, broad discussion, or preparation," criticizes Gerhard Hofmann, who was head of the Bundesbank's bank supervision department and is now managing board member of the National Association of German Cooperative Banks. "High-quality banking services—as with all services—depend primarily on the quality of people who devote their professional life to the task. Starting from scratch, with no supervision staff at all, is not putting the ECB in a pole position." And Hofmann continues: "Never before has banking supervision changed from seventeen national authorities to one supranational body in just a few months on a legal basis that appears to be very weak. With the banking union proposals, they [the EU leaders and EU Commission] put the cart before the horse. And we have to remind ourselves that a key feature of the recent financial crisis was supervisory failure and policy failure. Hoping that progress towards political union will be made as a result of far-reaching mutualization schemes could be a pipe dream with severe side effects. Moral hazard will be huge. But creating moral hazard is not a solid basis for mechanisms which are expected to create long-term benefits for societies."

From a German perspective, difficulties have been compounded by the recent ruling of the German Constitutional Court. The much-anticipated ruling confirmed the legality of the European Stability Mechanism, but also stipulated crucial legislative powers of control

The Bundesbank's Weidmann: Bank Supervision Will Destroy the ECB's Independence

The Bundesbank also is standing up against the banking union plans. "The primary goal of a banking union cannot be the sharing of risks," and "financial transfers should be made transparent and not hidden under the cloak of a banking union," warns Jens Weidmann, the Bundesbank's president.

He then shattered Club Med and French illusions of quickly using a new ECB supervision regime for direct bank financing in Spain or other weak eurozone countries by stating, "Any bank legacy problem must remain the liability of national regulatory regimes." He also insisted that bank supervision would destroy the ECB's independence and deflect from its price stability goal.

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Jens Weidmann

over the limits of German taxpayer exposure. That gives the Bundestag's budgeters a tighter grip on all euro rescue funds.

World Bank veteran and financial sector expert Achim Dübel, who is advising key members of the Bundestag's budget committee, recently spelled out the new hard line at a closed session of SPD lawmakers in the Bundestag. Dübel struck out at those who want to use the single supervisory mechanism to support the recapitalization of Spanish banks, arguing that, "Tackling the banking losses associated with the failure of national supervision by creating centralized supervision is tantamount to the defrauding of European taxpayers."

If mechanisms are being put in place to help Ireland and others, he said, "then why not also, for example, for the German states of North Rhine-Westphalia or Saxony that were hit hard by Landesbank insolvencies. Why should they not demand equal treatment and their historic losses be mutualized on a European level? Nobody can really intend to open this Pandora's box," reckons Dübel, adding, "Delinking of state and banking sector credit is another misleading headline intended to bring about debt mutualization."

Debt mutualization is not the only concern. There are also worries about the potential conflicts of interest that could arise if the ECB is made responsible for bank supervision as well as monetary policy, and worries, too, that the ECB's independence could be compromised. European Commission officials insist that they will secure an operational separation within the ECB between monetary policy tasks and supervisory tasks. Under the proposals to create the single supervisory mechanism, a separate supervisory board will be set up at the central bank to prepare decisions on supervisory matters. Critics do not seem convinced that this is sufficient and will work in practice on a European supranational level.

CLAWING BACK FROM BANKING UNION

The June EU summit initiative to construct a European banking union is getting second thoughts at the Berlin government's highest level. Since that summit, German Chancellor Merkel and Finance Minister Schäuble have been hardening their position while playing for time. What Brussels, France, and the increasingly powerful Club Med lobby decry as "a U-turn on banking union" is caused by the German government's response to domestic political and economic realities. The Merkel coalition government is struggling to justify its move toward a pan-European supervisory system to legislators, taxpayers, and savers, while making the argument that they do not want sick banks entering a banking union and that the European Stability Mechanism should deal with bad banks in such a way that the risk for the bank rescue remains inside the member state. Merkel—speaking before the chieftains of German industry together with ECB President Draghi—confirmed her strong opposition to "eurozone-level recapitalization of banks without structural reform." While Merkel has been hardening her line against Spain and other problem eurozone member countries, resistance in her own ruling conservative-liberal coalition against the single supervisory mechanism is mounting. As Schäuble told the *Wall Street Journal,* the German government is reluctant "to bring further bailout programs in front of the Bundestag," which is understandable in view of all parties starting to position themselves for next year's national elections.

At the Eurogroup finance ministers meeting in September in Cyprus, Schäuble embarked on shattering

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Club Med illusions that Germany would rush into a pan-European banking union in order to absorb the losses of failing Spanish banks. Then, when the finance ministers of Germany, the Netherlands and Finland—Schäuble, Jan Kees de Jager, and Jutta Urpilainen—met later in Helsinki, they said no to the assumption by Club Med countries such as Spain and Italy (also France) that they would be able to offload bad bank assets to EU rescue funds without issuing their governments' guarantees. "The European Stability Mechanism can take direct responsibility for problems that occur under the new supervision," says the communiqué after their meeting, "but legacy assets should be under the responsibility of national authorities." This means that Germany and other financially strong eurozone members rejected a plan to move bad bank assets off the books of struggling countries without recourse to the respective governments. This way a future pan-European supervisory system will only start with banks that have cleaned up their balance sheets.

German opposition to ECB banking supervision and debt mutualization is mounting from different corners. There are major controversial issues emerging prior to next year's federal elections. In no euro area country is the backlash to plans for an EU banking union stronger than in Germany.

On July 5, 2012, in an open letter published in the *Frankfurter Allgemeine Zeitung,* 172 economists appealed to the German public not to accept the euro summit decisions. The move to EU banking union means "that German citizens will be forced to be collectively liable for Eurosystem debts," warned the economists. Bank debts in the European banking union "will be three times larger than sovereign debts."

As expected, the two German banking groups most affected—savings banks and cooperative banks with their respective deposit insurance systems—have been mobilizing the public and their political levers to fight the single supervisory mechanism monster.

More positive is the reaction of the private banking sector with Deutsche Bank—the only globally operating German banking concern left—setting the tone among the Association of German Banks. In August, in a letter to Chancellor Merkel, Andreas Schmitz and Michael Kemmer, president and general manager respectively of the association, pressed ahead, welcoming the summit decision to put banking supervision for the six thousand banks in the euro area under the ECB's control.

Insiders see a hidden motive behind the more positive Deutsche Bank approach toward banking union. As by far the largest contributor to the private banks' deposit guarantee scheme, Deutsche Bank has a strong incentive to move into a new system with more burden sharing by other banks, it is said.

Many German savers and taxpayers have seen the full-page advertisements with an open letter by Georg Fahrenschon, president of the Association of German Savings Banks, and Uwe Fröhlich, president of the National Association of German Cooperative Banks, reminding Merkel of the promise she gave together with then-German Finance Minister Peer Steinbrück in October 2008 that "The savings are secure."

Representing eighty million customers, 435,000 bank employees in 423 savings banks, and 1,100 cooperative banks all over Germany, these two banking groups have enormous political clout. Placing an open letter in support of Angela Merkel defending the savings banks' and cooperative banks' deposit insurance systems in forthcoming negotiations on banking union may have been the first financial industry salvo against the ambitious and hastily concocted pan-European supervisory project with—apart from all questionable elements—impossible time schedules for implementation.

At the same time, the ruling coalition parties of the Christian Democratic Union and Christian Social Union along with the Free Democratic Party—with finance spokesman Klaus-Peter Flosbach (CDU) and deputy parliamentary leader Michael Meister (CDU) as key movers—put up the legislative defenses. They put through the Bundestag a resolution with far-reaching demands. It would limit the Berlin government in its negotiations on the Brussels stage by requiring that legacy risks are not covered by a banking union, insisting that only large banks of systemic importance would be supervised by the ECB after they undergo qualifying bank stress tests showing an adequate capitalization, rejecting any form of bringing in German deposit insurance funds into a pan-European deposit insurance scheme, and making sure that Berlin pushes for "a network of national resolution schemes" without cross-border mutualization of resources.

Regarding the lead role of the ECB in bank supervision, the resolution demands that "the independence and integrity of the ECB to conduct monetary policy is maintained. For this reason there would be a strict separation of personal and organizational set up (firewall) at the ECB level between those who are responsible for deciding on monetary policy and those who are charged with bank supervision."

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BERLIN'S BAD COMMUNICATION STRATEGY

The eurozone rescue strategy over the past three years, argues financial advisor Achim Dübel, "has entirely focused on taking either secured/preferred or at most senior unsecured financing positions." ECB bank funding operations are secured, however doubtfully, while the European Stability Mechanism has preferred creditor status. Even potential short-term government debt purchases by the ECB can be interpreted as such. "Only the temporary European Financial Stability Facility has ventured into unsecured positions, and promptly gobbled up high risk for taxpayers particularly in the Greek case," says Dübel. EFSF programs are being replaced by ESM programs.

Says Dübel, "The call for direct bank recapitalization pushed through by Italian Prime Minister Mario Monti at the June EU Summit was therefore tantamount to asking the eurozone to jump from the top of the capital structure to its very bottom. How far to the bottom, and how much loss-sharing would be involved, was a matter of circumstance in the Spanish case, since in the past years billions in junior-level bank debt that could have been used for loss absorption had been redeemed or converted under favorable conditions while the country remained in denial over the scale of the real estate crisis."

Continues Dübel, "By minimizing the capital available for a bail-in, Spain destroyed its own case for direct ESM capitalization, as the European Stability Mechanism became confronted with the prospect of higher-than-necessary loss expectation."

As a result, the German finance minister in July called for a Spanish sovereign guarantee for the ESM funds, and later in August for the anticipation of a bail-in regime already designed by the European Commission. In September, finally, the decision was made to not permit ESM funds to become commingled with legacy assets at all, that is, those assets for whose doubtful character past national regulation failure had been responsible. This, in effect, says Dübel "terminated some people's ideas of banking union as a loss, rather than risk, socialization vehicle."

The German communication strategy in the process, says Dübel, can only be described as chaotic and confusing. In his view, "Most damaging is the lack of personnel sufficiently educated in finance and with a minimum of knowledge about European financial systems at top government levels, both in the chancellery and the finance ministry." A contributing factor is the "silencing of any critical analysis inside Germany over the incidence of its own rescue operations of public banks, which had largely avoided bail-in and likely had served Spain as a model, in order to protect the political system."

EU leaders are again ready to break the European Treaty in a major way.

Concludes Dübel, "Since Germany's leaders both refuse and largely are unable to learn from their own failures, or successes, in bank resolution at home, they are also not in a position to lead the eurozone discussion in banking sector matters. The result is an unsatisfactory stop-and-go of external demands, initial consent, and later, when facts are sorted out in the German public discussion, rejection and change of course." ◆