Strange Bedfellows

Germany's split personality in its relations with the International Monetary Fund.

BY KLAUS C. ENGELEN

When a decade of pervasive governance failures and institutional inadequacies in the seventeen-member European Monetary Union became apparent as Greek default loomed early last year, European leaders—with German Chancellor Angela Merkel in the lead—responded by kicking the can down the road.

When historians of European integration look back, they will find the leading German central bankers—such as Jürgen Stark, the outgoing chief economist of the European Central Bank, his predecessor Otmar Issing, former Bundesbank President Axel Weber, and the former Bundesbank chief economist Hermann Remsperger—never stopped sounding urgent warnings about disregarding the fiscal rules of monetary union. Stark, who negotiated the Stability and Growth Pact as Germany's deputy finance minister, was especially critical of the eurozone's failing fiscal governance. Considering that, unlike the United States, United Kingdom, or Japan, the euro area's central bank is backed by seventeen national central banks, lacks the role of "lender of last resort," and operates under the constraints of the EU treaty, the eurozone is not a safe base for sovereigns and banks under mountains of debt in the event that global investors go on strike and rating agencies downgrade euro assets.

"The sovereign debt crisis in the euro area is a symptom of policy failures and deficiencies in—among other things—fiscal policy coordination," argued Stark and some of his ECB economists colleagues in a recent paper. "The first nine years of the euro were not used effectively in order to improve public finances while the Stability and Growth Pact was watered down. Spillovers from the financial and economic crisis compounded fiscal difficulties in the euro area, especially in certain member countries."

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But did the Bundesbank, forced by the politicians to replace the trusted deutschmark with a communized new currency, prepare itself for today's sovereign debt disaster? Did it look at what it could mean for its longstanding stake in the International Monetary Fund? Could this mean that one day euro area member debtors would ask for help from the IMF since the European Union was not able to come up with the necessary governance enforcement? What could all this mean for the character of the IMF as a cooperative monetary institution?

When the Greek crisis exploded, the German coalition government under Angela Merkel first tried to play for time. For as long as possible, Merkel tried to hide the emerging politically explosive burden-sharing consequences from voters. Resulting from a decade-long financial integration process in the eurozone, billion-euro rescue burdens were looming on the horizon, particularly from overextended, interconnected banking systems.

So first, growing external financing gaps of peripheral euro members with unsustainable debt levels were shifted to the European Central Bank and the European System of Central Banks. But soon, departing from the rule book and breaking with the Bundesbank's long-held and defended doctrine—that the IMF has no financing role in the eurozone since there could not arise a balance-of-payment need for EMU member states—the Merkel government opted to call in the IMF as lender and provider of conditionality to Greece, Ireland, and Portugal. Germany assumed a split personality in its IMF relations.

To highlight the bone of contention, Bundesbank watchers at the time pointed to a letter to the editors in the *Financial Times* on March 30, 2010, by Jacques R. Artus, former deputy director of the IMF's European department: "If it looks like a duck, swims like a duck, and quacks like a duck, then it probably is a duck." IMF assistance to Greece could only be viewed for what it would be, namely budgetary assistance rather than balance-of-payment assistance. Said Artus: "Greece has a lot of pressing economic difficulties but a lack of foreign exchange to service a public debt denominated in euros is not one of them."

Giving up the deutschmark was the political price to win France's support for German unification.

Jürgen Stark

Axel Weber

Sound the Alarm

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After a huge "troika" rescue operation involving the International Monetary Fund, the European Union, and the European Central Bank, the question Artus raised became ever more pressing: "Should the IMF be transformed into an International Budgetary Fund? Perhaps, but then should not this be done openly by changing the Articles of Agreement of the Fund? Would it not be ironical if the euro countries with a no-bailout clause in the Maastricht Treaty joined such an institution?" The former IMF official describes very well the Bundesbank's position on the IMF's role towards that part of its membership that forms the euro currency bloc.

GERMAN-IMF RELATIONS NO LONGER ON SURE FOOTING

Since August 14, 1952, when Hans E. Riesser, a German diplomat, signed the documents making the Federal Republic of Germany a member of the Fund, the German central bank, its managing board, and its staff has experienced ever-increasing importance and independence. Eventually the Bundesbank started acting as an orthodox, conservative, monetary policy counterweight to the mighty and expansionist U.S. Federal Reserve. Giving up its institutional independence and global monetary power to become part of the European System of Central Banks was a humiliating and painful process. For many Germans, giving up the deutschmark was the political price to win France's support for German unification.

For more than half a century, German relations with the IMF stood on the sure footing of German governments in different party coalitions working closely together with the Bundesbank. This strengthened the German role in the Fund, where the Americans as largest shareholder, along with other shrewd power players in financial diplomacy such as the French and the British, dominated the policies, politics, and management of the Bretton Woods institution that was established to provide short-term balance-of-payments financing to an ever-larger global membership of nations.

Based on a broad Bundesbank mandate, for decades common priorities and a common *modus operandi* between German governments and the central bank shaped Germany's position in the Fund, with the Bundesbank usually leading the way.

But when the fiscal pressures of the euro sovereign debt and banking crisis escalated, the Bundesbank and the German government were no longer marching to the same drum. Partly siding with the European Central Bank and partly standing alone, the Bundesbank—both openly and behind closed doors—moved closer to a collision course with the Berlin government under Merkel and German Finance Minister Schäuble, thus complicating Germany's relations with the Fund.

Since the euro crisis erupted, German relations with the IMF have been marked by discord and tension. Disunity between Berlin and Frankfurt is causing collateral damage in many areas. With two sharply different responses to the euro debt and banking challenges, Germany's standing in the field of international financial diplomacy has been weakened, although Chancellor Merkel, acting in tandem with French President Nicolas Sarkozy, was able to impose Berlin's radical fiscal stabilization cures on the whole eurozone.

Germany's internal divisions on how to deal with the crisis are a disruptive development that is damaging major European institutions, including the ECB and the euro area's national central banks as well as the EU Commission. By calling in the IMF as a major lender, the Europeans also have been gravely undermining the cooperative monetary character of the Fund with far-reaching regional and global implications for the economies of its membership.

Germany—both the Berlin government and the Frankfurt Bundesbank—are now sailing in uncharted waters and risk wrecking the ship on hidden shoals. For more than half a century the Bundesbank—and the German government—were able to shape their relations with the IMF from a strong position as reserve asset provider, making sure that the institution's resources to finance short-term balance-of-payment deficits were spent with adequate conditionality. This has changed as Germany and the Bundesbank have moved to the client side. Germany, as major rescuer and guarantor of highly indebted eurozone countries, could be made liable for a large share of IMF standby loans disbursed to Greece, Ireland, and Portugal in case these countries do not repay their debts. The IMF acts as preferred creditor and always will be repaid.

For some observers, even greater challenges for Germany and the Bundesbank come from the European Commission and the ECB using the euro crisis and the G-20 efforts to reform the IMF's governance structure as a political lever to push for a single seat for the euro area. So far, the Bundesbank's position, backed by the German government, is that a single euro-area representation would require transfer of national power and could weaken Europe's influence, and that conditions for a single seat will not exist in the foreseeable future.

OUTSOURCING THE EURO CRISIS TO THE IMF

When the Greek crisis came into focus early last year, then-French finance and economic minister Christine Lagarde—now managing director of the IMF—initially seemed to have shared the Bundesbank's view that calling on the IMF for budgetary assistance would be a mistake. She was quoted asking whether the U.S. government would call in the IMF to rescue the State of California as it lumbers under a mountain of debt and moves close to insolvency.

And Hermann Remsperger, as member of the Bundesbank's board from 1998 to 2009, warned in his speech at the IMF Annual Meeting on October 13,

Angela Merkel

Merkel's Playtoy

To the horror of German central bankers and monetary experts, German Chancellor Angela Merkel seems to view the IMF as a mixture of an emerging "world central bank" and an "International Budgetary Fund."

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Buba's Weidmann: Target of Silver Bullet

"For weeks, Weidmann's resistance has been the dominant topic at all financial summits. In Germany, the central banker knows that he enjoys the support of the majority of the population and most experts. But the pressure from abroad is growing. From U.S. President Barack Obama to French President Nicolas Sarkozy to European Commission President José Manuel Barroso, all are urging the Germans to abandon their resistance to the ECB plan. The ECB, the London-based *Financial Times* wrote last week, must finally use its 'silver bullet.'"

—*Der Spiegel*

Jens Weidmann

2008: "The lending framework must remain firmly based on the Fund's fundamental lending principles. These include in particular the concepts of conditionality, balance-of-payments need, and the exceptional access criteria. They are essential to safeguarding the Fund's resources and they have not hampered the provision of financial support in times of crisis."

In March of last year, when the Bundesbank was forced to yield to the controversial decision of the Merkel government to call the IMF into the euro area as major lender in the Greek rescue, this opened an unprecedented "schism" between the politicians in Berlin and the central bankers in Frankfurt on how to organize the rescue. Their sharp differences in approach fractured Germany's position on the European state, globally and especially towards the IMF.

Greece was able to obtain a commitment from the Fund for a multi-year program under a Stand-By Arrangement for a period of thirty-six months in an amount equal to SDR 26.4 billion (an unprecedentedly high access to the Fund's resources of 3,200 percent of Greece's quota). A parallel request for financial assistance to euro area countries for a total amount of €80 billion has been sent. The IMF, the European Commission, and the European Central Bank will work together in a "troika" to assist Greece in the euro crisis.

Over decades the Bundesbank—mostly supported by German governments in different party coalitions—had defended the role of the IMF as a cooperative quota-based monetary institution. This meant using Germany's seat on the twenty-four-member Executive Board to oppose using the reserve asset base of the IMF to provide budget assistance in domestic rather than foreign currency for member countries. The aim was to block the IMF from monetization of member countries' fiscal deficits for fear of increasing global inflation.

This explains why among IMF experts at the Bundesbank and the Federal Finance Ministry there was doomsday talk of a "Supergau" and "self destruction" weakening Germany's position in the Fund and in the field of international financial diplomacy.

As the third-largest stakeholder of the IMF and a heavyweight in the European and global economy, Germany for many decades led the fraction of member countries that acted as "stability guardians" in the Fund. When the IMF staff and the IMF Executive Board had to evaluate country lending programs, these guardians of stability and strict conditionality used their voting power to make sure that the debtors met the preconditions under the Articles of Agreement that fund assistance requires from the member countries that need to purchase foreign currency in order to stabilize their exchange rates. This requirement is best demonstrated by the fact that the IMF does not grant loans like banks and credit institutions do, but only allows its members to temporarily "purchase" another member's currency. In contrast, covering domestic financing needs does not require an exchange of currencies, but instead the ability to acquire domestic currency in exchange for a claim on future repayments.

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As a veteran Bundesbank watcher recalls, on that day the Bundesbank—and Germany—lost credibility as a staunch guardian of conditionality in the IMF's balance-of-payments lending. The Berlin government "ignores what German governments and the Bundesbank have been preaching for decades to the Fund's membership: that IMF funds, provided by central banks, should not be used to finance member states' fiscal deficits."

For the first time in its relations with the IMF, a German government was lending a hand to open the floodgates of central bank financing of countries' fiscal deficits, thus providing a potential route for circumventing direct ECB lending to eurozone members which is forbidden under the EU treaties. This is one of the reasons why euro area central banks react very sensitively to the current discussions about a potential increase in the Fund's resources, as they stay committed to the provision of monetary financing set out in the EU treaties.

Considering the complexity of rescue finance through central bank channels—in particular Germany's split in relations with the Fund—the lack of media coverage and public discussion was not surprising.

But what has emerged since the IMF entered the euro debt crisis is a colossal failure of eurozone political crisis management. Even the IMF has been sharply critical. In its report on its regular consultation with the euro area in summer 2011, for example, IMF staff blasted the uncertainty which had been created concerning the modalities for private sector involvement in future cases of financial assistance and emphasized that "it will be important to bring the discussion about private sector involvement to completion—both in specific programs and in the context of the ESM [European Stability Mechanism]." In a recent editorial (December 19, 2011), the *Financial Times* hit at Europe's failures with these words: "The sad truth is that, by calling in the involvement of the IMF, European countries are confirming how little trust they have in each other. Rather than chasing yet another not-so-clever plan, the EU must restore a common purpose and a sense of solidarity. The way out of the crisis is not to act as a group of states that just happen to share a common currency."

From a German perspective, here are some of the failings in responding to the Greek disaster spreading to the whole euro area.

Merkel, an East German scientist who rose spectacularly in the politics of a united Germany, and her finance minister Schäuble, a lawyer, member of several coalition governments, and survivor of many political battles, did not assemble a group of banking and capital market experts to advise the German government.

So the question arises: Why did Merkel's chief economic advisor and now Bundesbank President Jens Weidmann, a macroeconomist and not a capital market expert, not reach out to secure more financial market expertise to advise Berlin's crisis management? Did he counsel Merkel to reject a crucial private-public bridge loan to Greece in the spring of last year of about €30 billion that was planned by Deutsche Bank CEO Josef Ackermann to give European leaders time to prepare for the solvency threat in the eurozone?

Further questions must be asked about the "pragmatic" and "flexible" Jörg Asmussen, who as deputy finance minister played a key role in negotiating the temporary European Financial Stability Facility and the permanent European Stability Mechanism. He also managed Berlin's radical change in Germany's relations with the Fund, and was Germany's front-man for Berlin's private sector involvement strategy that failed dismally. Asmussen eventually turned out to be the only credible German candidate left that the Merkel government could get nominated to fill the vacancy in the ECB Managing Board after the early resignation of Jürgen Stark.

To the horror of German central bankers and monetary experts, Merkel seems to view the IMF as a mixture of an emerging "world central bank" and an "International Budgetary Fund." She went on a collision course with the Bundesbank causing irreparable damage for the German central bank's role in the Fund. At the time, dire predictions over the downside risks of outsourcing the Greek rescue to the IMF were spreading among the network of public officials in treasuries, central banks, the ECB, the EU Commission, and European think tanks. They were, however, discarded by Berlin's ruling politicians under the strong influence of top French rescue managers—first then-IMF head Dominique Strauss-Kahn, then his successor Christine Lagarde, along with French president Nicolas Sarkozy. The fact that French leaders in the tradition of the "Grande Nation" have no high regard of central bank independence did not matter to those in the Berlin driver's seat.

The German government's push for private sector involvement and calls for "hair cuts" on euro bonds—a euphemism for making investors take losses on bond holdings—increased risk spreads, drove up risk insurance and interest rate costs for highly indebted sovereigns, and led to a broad-based investor strike.

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In the view of central bankers who point to a decade of integration in euro area's financial sectors, Merkel's famous walk on the Deauville Beach with Sarkozy (where she got the go-ahead for private sector involvement and a green light for a permanent European rescue fund, a European Stability Mechanism is seen inflicting lasting damage to euro debt as an investment asset.

Was Berlin's insistence on private sector involvement in retrospect a strategic mistake? The answer that Europe's most important financial market expert, ECB President Mario Draghi, gave to this question in a December 19 interview in the *Financial Times* was not complimentary for Merkozy, Schäuble, and company. "Neither the EFSF was in place nor were banks recapitalized before people started suggesting PSI. It was like letting a bank fail without having a proper mechanism for managing this failure, as it had happened with Lehman."

Since the December EU summit, European leaders rethinking last year's push by Merkozy for private sector involvement is on the record. Whether accepting the "voluntary" Greek private sector involvement effort will work remains to be seen. The question remains whether markets really believe in the EU summit embarking on rolling back ambitious private-sector involvement plans by changing to "IMF principles and doctrines"—whatever that means. Investors won't forget how many times EU governments did not live up to their promises and announcements. But EU President Herman Van Rompuy's *mea culpa* might help: "Our first approach to PSI, which had a very negative effect on debt markets, is now officially over."

When the eurozone central banks started purchasing securities in the context of the Securities Markets Programme, unprecedented disputes and tensions erupted between the ECB and the Bundesbank. But the Berlin government—under mounting pressure to stem the market onslaught against the euro periphery reaching Italy and Spain—kept its powder dry.

In fairness to the Berlin government, it can't be overlooked that Merkel and Schäuble, supported by the conservative and liberal coalition parties, so far have sided with the Bundesbank on rejecting the common issuance of "eurobonds" or "stability bonds" and have not accepted calls by France and other eurozone governments to provide the European bailout facility EFSF with a banking license so it could be refinanced by the ECB. This cannot be said for Germany's opposition parties, the Social Democrats (SPD) and the Greens, let alone the Linke.

The spectacular resignations of the top German central bankers—first Axel Weber, the president of the Bundesbank and the German candidate to succeed Jean-Claude Trichet to head the ECB, in February of this year, followed on September 9 by Jürgen Stark, the ECB's chief economist and managing board member—can be seen in the context of how much the traditional Bundesbank stability culture has been sidelined since the euro debt crisis put more political pressure on the ECB and the European central bank system.

Both Weber and Stark opposed leading the ECB into "monetization of fiscal deficits" by purchasing sovereign eurozone debt. They were deeply disappointed in not getting more help from those responsible in the German government. This disappointment motivated both top German representatives at the ECB to quit. Stark, who stepped down at the end of 2011, announced his resignation in September for "personal reasons." But recently Stark told the German business magazine *WirtschaftsWoche,* "There is one big topic that explains (my resignation). I am not satisfied with how this currency union has evolved."

What became apparent to both Stark and Weber may become even more politically explosive for a German public steeped in the economic orthodoxy of stable money and fighting inflation: that more and more the central bankers from highly indebted and fiscally profligate member countries dominate the ECB Council's expansionist monetary and market policies.

Then came the big surprise. As it turned out, Jens Weidmann, the forty-three-year-old new Bundesbank president, took up the fight that Weber and Stark couldn't win. The magazine *Der Spiegel* recently headlined a large feature on Weidmann, "Saving the Euro: Germany's Central Bank against the World." To quote the article: "In the battle to save the euro, Europe's monetary watchdogs are under growing pressure from around the world to buy up unlimited quantities of the sovereign bonds of ailing member states. But the head of the Bundesbank is saying no, and he is making his message loud and clear, not only in Berlin, but also in Brussels, Paris, and Washington. If the ECB gave in to the pressure, Weidmann argues, it would not only be violating European treaties and the German constitution. Such a move would also be 'synonymous with the issuance of euro bonds.'"

And *Der Spiegel* continues: "For weeks, Weidmann's resistance has been the dominant topic at all financial summits. In Germany, the central banker knows that he enjoys the support of the majority of the population and most experts. But the pressure from abroad is growing. From U.S. President Barack Obama to French President Nicolas Sarkozy to European Commission President José Manuel Barroso, all are urging the Germans to abandon their resistance to the ECB plan. The ECB, the London-based *Financial Times* wrote last week, must finally use its 'silver bullet.'"

HOW THE BUNDESBANK WARNED BERLIN'S EURO RESCUERS

When monetary historians look at how the Bundesbank's experts put on record the implications for Germany's actions regarding the IMF, one question arises.

Why did Axel Weber at the time not voice publicly the central bank's opposition to a potential role for the IMF as lender in the euro area rescue? Weber also kept quiet when, in a stunning move and without any prior deliberations, the G-20 meeting in London in April 2009 decided to instruct the IMF to issue $250 billion in Special Drawing Rights, the Fund's "paper money." By contrast, as a profile in courage, Weber's former Bundesbank vice president Jürgen Stark, in an interview with *Handelsblatt,* did come out condemning the G-20 deal as "helicopter money for the globe." Stark criticized the G-20 and also by implication the German government and the Bundesbank for letting this happen. "There hasn't been a study to see whether the world needs additional liquidity … In the old days one would take a long time to explore such a thing," Stark told *Handelsblatt.*

In light of how the Greek disaster has escalated into a full-blown crisis, it is fascinating to read how the Bundesbank's Monthly Report for March 2010 spelled out the reasons why Germany should "maintain the Fund's monetary character" in view of the financial obligations to be borne by Germany or the Bundesbank.

The report makes other important points, including how, in line with the Fund's mandate, it may use the provided foreign reserves only to help overcome short-term balance of payments difficulties and thus cover a temporary need for foreign currency, and that by contrast, any financial contribution by the Fund to solve structural problems that do not imply a need for foreign currency—such as the direct financing of budget deficits or financing of bank recapitalization—would be incompatible with its monetary mandate.

But what does this mean for the eurozone countries to borrow from the Fund on the basis of their quota rights?

Since from the beginning of the Greek rescue, for politicians desperately looking for financing sources, exercising the financial rights of the euro area countries toward the IMF has looked inviting. One has to go back very far to the September 1999 Monthly Report in order to find this issue explored by the Bundesbank in depth.

The Bundesbank pointed out then that getting IMF financial assistance is "a balance of payments need," noting that "the euro area countries are quite unlikely to have such a need," but admitting: "Therefore, the implications of the introduction of the euro for the procedures in the event a euro area country wants to make use of IMF credit have so far been discussed only in passing." The Bundesbank expected that "It is widely held that there is no such thing as an individual balance of payments need for geographical parts of the euro area. These parts do not have a currency of their own, making the transactions of the individual euro area countries with foreign countries irrelevant. The euro has replaced the national currencies and defines the new currency area, which means that a balance of payments need can only exist for the euro area."

Speculating about future needs, the Bundesbank's experts were quite off the mark when they drew up this scenario: "It is conceivable that a single country might be able to trigger such a need, say, through excessive government indebtedness in foreign currency. Apart from that, only IMF member countries are entitled to request balance of payment assistance, i.e. only individual euro area countries." Then comes the confident look into the single currency's future: "As the prospect of euro area countries needing to make use of these resources is quite unlikely, this issue is not urgent."

WEIDMANN'S TROUBLES WITH BERLIN CONTINUE

As the Bundesbank and the German government sink deeper into another of those confidence-eroding conflicts—this time over Germany's €45 billion back-up contribution to the IMF as part of the recent EU summit imposition on EU central banks to provide bilateral credits for the IMF general account—Germany's new constitutional limits to providing new euro rescue guarantees and funds are being tested.

Euro area governments, facing mounting difficulties in leveraging the EFSF rescue fund, have embarked on another of those rescue efforts by shifting the financing burden to central banks. The ECB's Jürgen Stark characterized the decision of the last EU summit to increase the involvement of the IMF in the euro crisis as an "act of des-

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peration." Talking to the *Süddeutsche Zeitung,* Stark asked the poignant question: "But where should the money come from? If it came from the central bank, it would be indirect monetary financing. In the end it is the European taxpayer who is liable."

At their European Council meeting in Brussels on December 9, 2011, most EU leaders not only agreed on a "fiscal compact" but also on mobilizing additional backup financing through bilateral loans by their central banks to the IMF in order to enlarge the IMF's firepower for further rescue operations. "Euro area and other Member States will consider and confirm within ten days," reads the EU summit statement, "the provision of additional resources for the IMF of up to €200 billion (US$270 billion), in the form of bilateral loans, to ensure that the IMF has adequate resources to deal with the crisis. We are looking forward to parallel contributions from the international community." The EU summit's IMF backup call would mean €150 billion for eurozone central banks and €50 billion for EU central banks outside the euro area. The German central bank's share would be almost €45 billion.

But it wasn't long before UK Chancellor of the Exchequer George Osborne told his twenty-six EU counterparts in a conference call that the United Kingdom would not offer extra IMF funds unless it were part of a wider international effort. There had been speculation that the United Kingdom would provide €30 billion to the IMF backup initiative. Soon it became apparent also that the Obama Administration would not dare to ask the Republican-dominated U.S. House of Representatives to take part.

Another example of how Jens Weidmann, since becoming president of the Bundesbank, has defended the bank's position: After blocking French proposals to increase the EFSF's firepower by pooling Special Drawing Rights that eurozone central banks hold in the Fund, and also after putting down the idea that the European Central Bank, in spite of not being an IMF member, could lend to the Fund directly, thus enlarging its refinancing base to help the eurozone, the Bundesbank laid down tough conditions for coming up with IMF backup loans.

In a letter to German Finance Minister Schäuble, Weidmann and his managing board member in charge of financial stability, Andreas Dombret, argued that the Bundesbank would only be willing to provide further resources to the IMF as part of a solution to the eurozone debt crisis if other EU and non-EU countries did the same. This meant that the Bundesbank wanted to wait until there were indications of whether the United States, China, or other major members of the Fund would be contributing. The Bundesbank also observed closely how other central banks responded to the EU leaders' request for IMF backup loans.

The letter also stressed that the IMF procedure involved risks. Because the IMF is treated as a preferred creditor, this would increase the risk for other creditors, the Bundesbank warned. "In the specific case of Europe, it should be noted that the risk for other inter-government rescue loans could rise significantly." Heaping another layer of preferred IMF claims on the eurozone debtors and rescue guarantors, the Bundesbank feared, might keep investors from holding or buying euro debt assets.

After analyzing the EU summit move to have central banks extend bilateral loans to strengthen IMF resources, the Bundesbank came to the conclusion that the IMF backup loans would result in much higher risks for German taxpayers. In providing the new bilateral loans to the IMF, the Bundesbank would go beyond the current limit for new German pledges of €211 billion and thus break the newly amended constitutional law. Therefore, the central bank would have to obtain special legislative approval from the Bundestag's budget committee. On September 6, 2011, the German Federal Constitutional Court stipulated that the Bundestag needed to be given a greater say in future bailout measures. Implementing the Constitutional Court decision, the Bundestag passed a resolution giving the Bundestag's budget committee greater control powers over new euro rescue pledges.

But lawmakers from Chancellor Merkel's coalition refused to vote on a plan to use central bank loans to increase the IMF's lending capacity. When Bundesbank President Weidmann asked the budget committee chairperson from the Social Democratic Party for a chance to make his case, he got a date to testify. But in an unprecedented confrontational move, the ruling coalition members on the budget committee refused to let the central bank testify for a separate budget committee authorization of the IMF backup lending as the law—in the view of the Bundesbank—requires.

So the conflict between Berlin's lawmakers and the German central bank remains unsolved as we go to press. ◆