A differing opinion

91. One member of the German Council of Economic Experts, Peter Bofinger, has a different opinion regarding the views presented in this chapter.

92. The majority of Council members puts this chapter under the heading "Focus on Future Viability". To a large part, economic policies are being proposed that would weaken the role of the government in the economy. In the view of the majority of Council members, future viability appears to imply an economic order with **more market and less government**. However, the experience with the German reunification , the Global Financial Crisis and most recently the refugee crisis shows how fast unexpected, large challenges can emerge which can only be managed by a government that is ready and able to act.

93. The reforms proposed in this report by the majority of Council members would limit the **government's ability to act** considerably:

   - This is especially true for the proposed **sovereign insolvency mechanism** and, related to this, the removal of regulatory privileges of sovereign exposures in bank balance sheets. This would radically limit the financial space and thus the ability of governments to intervene, especially in times of crises.
   - Investor-state dispute settlemente context of **TTIP** would strengthen the position of foreign enterprises in legal disputes vis-à-vis the government. Moreover, regulations in the field of consumer and environmental protection may get untermined by the country-of-origin principle, while economic benefits are uncertain.
   - The proposed tax allowance for corporate equity (ACE) would lead to a considerable loss of tax revenues. This tax rule would have basically the same effect like introducing an asymmetric negative wealth tax while leaving corporate tax rules unchanged. The resulting tax benefit would primarily accrue to wealthy individuals. The already high concentration of private wealth in Germany would thus increase further. The tax disadvantages for equity vis-à-vis debt, which the majority of Council members laments, could be removed without tax revenue loss by substituting the withholding tax on interest incomes by the personal income tax.

94. In addition, the majority calls for a withdrawal of the state from key areas of economic policy, without providing convincing arguments:

   - The scope of the newly introduced **minimum wage** should be restricted, although employment has risen stronger in industries more affected by the minimum wage than in industries which are less affected. ↘ ITEM 36
   - The **external flexibility on the labour market** should be strengthened although the German labour market could hardly be doing better - despite high job security indeed.

– Energy policy should phase out **subsidies for renewable energy**, despite the fact that similar schemes are in place in 145 countries. Instead, the majority proposes to strengthen the European emission trading system. ↘ ITEM 86

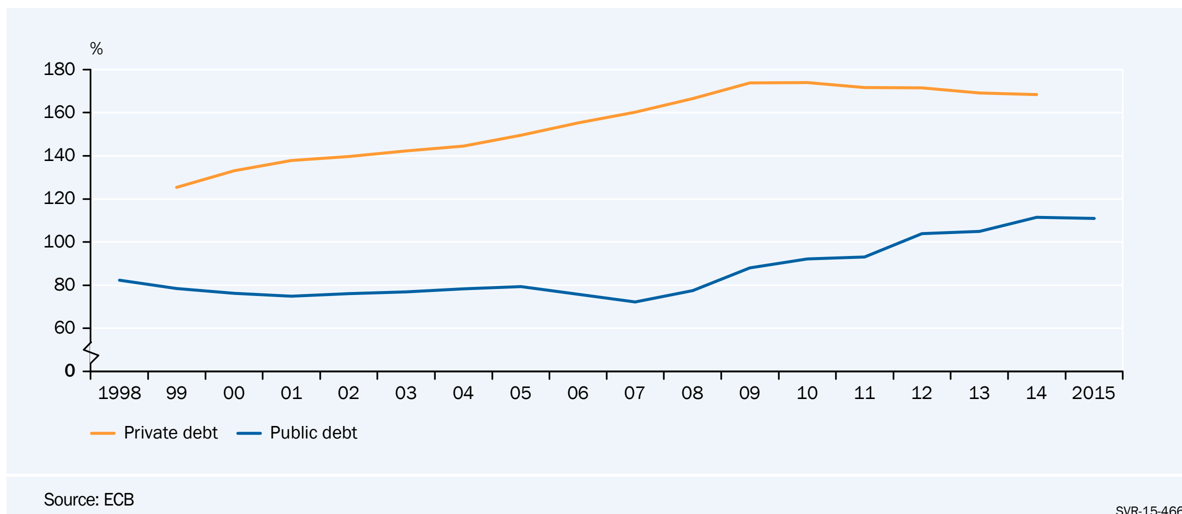
– The just recently abolished **tuition fees** should be re-introduced. ↘ ITEM 84

– Finally, the policy of the **European Central Bank** (ECB) is considered too expansive. The ECB should slow its government bond purchasing programme or even end it earlier than initially announced. ↘ ITEM 14 Yet, the majority of Council members acknowledges that the ECB contributed to the economic recovery in the euro area.

95. The most far reaching suggestion is the introduction of a **sovereign insolvency mechanism**. In this regard it should be accepted that "the severity of the euro area crisis" ↘ ITEM 52 is first of all a consequence of wrong decisions by private agents, and only partly a consequence of excessive public debt. Until the outbreak of the crisis in 2008, public debt ratios in the euro area had been decreasing whereas the debt levels of corporations and private households had been expanding faster than output. ↘ CHART 8 After the outbreak of the crisis, a notable increase of public debt can be observed. To a large extent, this is due to the fact that, after the excesses of the financial markets, the private economy was stabilised through massive government interventions.

↘ CHART 8

Private and public debt in the euro area
in percent of nominal GDP



Source: ECB

SVR-15-466

96. The majority primarily regards the sovereign insolvency mechanism as a contribution to **strengthen the market discipline** vis-à-vis sovereign countries. ↘ ITEM 48 This approach appears questionable given the crisis was predominantly caused by a misjudgement of markets. The general question to be asked is therefore what qualifies markets for such a far-reaching function (GCEE Special Report items 112 ff). The episode prior to 26 June 2012, the day when Mario Draghi succeeded in stabilising the euro area by giving his famous speech, illustrates that financial markets are not rational and tend to overreact.

97. The majority of the Council members concedes such aberration. In periods of higher uncertainty, they state that there is a **risk of severe**, **in part excessive reactions on the financial markets**, which creates multiple equilibria in the sense of a self-fulfilling prophecy. ↘ ITEM 47 However, the majority then asserts that a sovereign insolvency mechanism would guide expectations of market participants to limit such effects. However, it remains unclear how this works.

98. It is more likely that the insolvency mechanism would destabilise expectations of market participants in times of crisis. An insolvency regime could result in a **bond-run**, where investors fire-sell sovereign bonds to avoid a haircut.

In practice, such an insolvency mechanism implies that more indebted member states would not have the possibility to stabilise the economy in case of severe economic or financial crises.

Because of the insolvency mechanism, these countries are at risk of being hit by a dangerous confidence crisis. Experience of the last ten years has shown how fast a severe crisis can occur which calls for massive state intervention. Countries which can become insolvent would not be able to stabilise the economy in case of crisis. If in case of a severe crisis the macroeconomic stability is not guaranteed, the stability of the banking system would be significantly negatively affected. Due to this, a sovereign insolvency mechanism would be counterproductive.

99. Therefore, a sovereign insolvency mechanism very likely would not stabilise the **architecture** of the monetary union, but rather destabilise it. The euro area's capacity to act in case of a large shock requires that interventions on goods and financial markets can take place in severe crises **without financial restrictions**. This point is proven by the very large public deficits that governments in the US, the UK, and Japan incurred in response to the global economic and financial crisis. The crisis in the euro area in 2010-12 already mirrored the member states' restricted capacity to act due to their membership of the monetary union. In contrast to other highly developed countries, the national debt of the euro area member states is denominated in a currency that the national states cannot issue independently.

100. In the past years, the convincing and pragmatic actions of the **European Central Bank** have ensured that the euro area was stabilised. If the ECB cannot assume this – even for itself – problematic role, policies that can lead to higher instability of the euro area should not be promoted.

Instead, solutions should be pursued that combine necessary fiscal discipline with an unrestricted fiscal policy to act in times of crisis. This necessitates a transfer of fiscal sovereignty from the national to the European level as well as mechanisms for a common liability for government bonds. Without the willingness to engage in further political integration, a stable architecture of the euro area is not in sight. Once the capability to act is ensured at the European level, an insolvency mechanism for individual member states could be discussed again.

101. The **removal of regulatory privileges for sovereign exposures** in bank balance sheets creates a **competitive disadvantage for banks in the euro area** since it should not be expected that other countries introduce similar regulations. The proposed capital requirement for sovereign exposures would increase the funding costs of governments, thus making it more difficult for governments to reduce their debt. Moreover, the proposal would not help banks' profitability. That the "purported competitive disadvantage" is compensated by a more stable euro area ↘ ITEM 63 would only be true if one – as the majority of Council members does – believes in such stabilisation effects. Furthermore, there will not remain any "safe asset" for investment in the euro area any more.

Moreover, the removal of regulatory privileges interferes with bank preferences and would force them to swap current holdings – which are in their view absolutely safe, in particular German Bunds – with bonds of other member states which they view as less safe. At the same time, the proponents of **large exposure limits for sovereign bonds** seem to overlook that an intervention limiting free investment choices limits market discipline.

102. Also in this Annual Economic Report the majority of Council members is in favour of ending subsidies for renewable energy under the Renewable Energy Act (*Erneuerbare-Energien-Gesetz, EEG*). ↘ ITEM 86 It is seen as the wrong way to go.

After all, the fact that 145 countries are currently subsidising renewable energies should be something to think about. These subsidies mostly are part of a model for feed-in tariffs (REN21, 2015). As in Germany, the trend is moving increasingly towards auctions (Bofinger, 2013; Bofinger et al., 2015) which are already in use in 60 countries. In 2014, China, the US, and Japan made the largest investments in renewable energy. To this end, many regard Germany as a useful role model for global climate potection (Wagner und Eitzman, 2015). However, this does not imply that the EEG cannot be improved. Hence the Germany government is intensively working on curbing the „cost explosion" by providing subsidies based on tenders.

103. The promotion of renewable energy does not contradict a **trading system for greenhouse gas emissions** in principle. The target quantities set under such a trading system should take into account that the burden imposed on the economy remains bearable. The price drop caused by the promotion of renewable energy suggests that ambitious targets under the EU Emissions Trading System (EU ETS) are achievable. Without the Renewable Energy Act, the EU-ETS would presumably not have resulted in substantial technological progress since, as acknowledged by the majority, it disappointed expectations in Europe so far. Moreover, given the lack of interest in an international CO_2-trading system to date, no progress on climate change would have been achieved on global level.

104. **A uniform Pigou-tax**, as proposed by Edenhofer and Ockenfels (2015) or by Wagner and Weitzman (2015), appears more promising than quantitative ceilings. For Europe, this would require a price floor in the emissions trading system. Along the same lines, the majority of Council members also favours a **price corridor**. Edenhofer and Ockenfels see an essential advantage of an international price target in its compatibility with national subsidies for renewable en-

ergy. While such measures have only led to a deferral of emissions so far, a price floor would guarantee that additional reductions of emissions could be achieved. In turn, the low-cost availability of renewable energy might increase the willingness of countries to introduce such a global tax.

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