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SAFE Finance Blog

The Debate on the Target Balances

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The target balances generate discussions in the public and among economists who come to very different results in their analyses. An overview of the most important arguments



"Deutscher Target-Saldo fällt um fast 100 Milliarden Euro (<https://www.faz.net/aktuell/finanzen/deutscher-target-saldo-faellt-um-fast-100-milliarden-euro-16031502.html>)" ("German target balance falls by almost 100 billion euros") headlined the daily newspaper „Frankfurter Allgemeine Zeitung“ (FAZ) a few days ago. In July last year, on the other hand, „ARD.de“ posted “Target-Salden auf Rekordniveau

(<https://boerse.ard.de/anlagestrategie/konjunktur/target-salden-auf-rekordniveau100.html>)" ("Target balances at record levels"). And the newspaper “Tagesspiegel” asked in September 2018: "Billionen Bombe oder Panikmache? (<https://www.tagesspiegel.de/wirtschaft/target-2-billionen-bombe-oder->

panikmache/22982958.html)" ("Billion bomb or scare tactics?")

These are only three exemplary headlines from the past months. However, they do show the power of the debate about the actual or supposed threats of target balances in the public. More headlines are certain with every downward or upward movement. TARGET (Trans-European Automated Real-time Gross Settlement Express Transfer System) is an infrastructure offered by the system of European central banks since 1998 and expanded in 2002 for the fast and smooth processing of international money transfers. The system bundles payments from account holders in one country to payees in other countries. The central bank of the respective recipient country forwards these payments to the end recipient, a person or a company. Since here central bank money is transferred – so bookings take place between central banks that are integrated into a common currency system – unbalanced transaction balances can arise between the central banks. Because the mutual payments between two countries within a given period of time are usually different, there are daily surpluses or deficits on the various central bank accounts which manifest in the target balances.

Time and again, these balances are the subject of public controversy. There have been repeated calls for policymakers to act immediately to prevent the emergence of the balances or at least to collateralize their amounts.

In fact, however, there are very different views among experts on the phenomenon of target balances, who have published their views in various working papers and guest articles in the press. Interestingly, a supposed threat to the monetary union through the balances is discussed almost exclusively among German economists.

In the SAFE Policy Blog, we want to summarize the state of the debate. Our goal is to start and continue a discussion until a certain clarification of the meaning of target balances emerges. With a brief summary of the arguments brought up and links to longer texts, we also want to offer non-experts a better orientation on this technically difficult topic.

The course of the debate so far

Especially in Germany, some authors point out with verve the threatening dangers of constantly growing target balances. These include the economist Hans-Werner Sinn (<http://www.hanswernersinn.de/>), who was the first scholar to point out the growing target balances, as well as, among others, Clemens Fuest (<https://www.cesifo-group.de/de/fuest-c>), Stefan Homburg (<https://www.fwi.uni-hannover.de/homburg.html>), Thomas Mayer (<https://www.flossbachvonstorch-researchinstitute.com/de/ueber-uns/team/>), and Ulrich van Suntum (<https://www.wiwi.uni-muenster.de/insiw0/de/das-institut/personen/ulrich-suntum>).

Other economists oppose the proposition of the target threats. They deny that the balances themselves are significant macroeconomic risks and that they lead to a communitarization of risks at the level of the European Monetary Union. These include Martin Hellwig (<https://www.coll.mpg.de/martin-hellwig>), Klaus Adam (<https://www.vwl.uni-mannheim.de/adam/>), Adalbert Winkler (<https://www.frankfurt-school.de/home/research/staff/Adalbert-Winkler>) and myself (<https://safe-frankfurt.de/de/forschung/wissenschaftler/details/showauthor/14-krahen.html>). Central bank specialists, for example from the European Central Bank (ECB), also deny the risks of the target balances, for example here (<https://www.econstor.eu/bitstream/10419/175738/1/ecb-op196-en.pdf>) or here (<http://www.macro-economics.tu-berlin.de/fileadmin/fg124/koenig/papers/kuk.45.2.pdf>).

Due to the different – almost diametrically opposed – analyses, the political recommendations of the economists also differ.

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Therefore, the target critics demand to abandon the target payment system. They also want that any balances should be secured with bonds or gold, and that balances be settled regularly. The target defenders, on the other hand, propose the transition to a joint payment account of the ECB and call for a rapid and complete implementation of the banking union to stabilize the solvency of national central banks. In addition, they generally doubt the receivables character of target balances: For them, the balances are therefore merely balance sheet items.

Here is an overview of the most important arguments and texts:

- The debate starts in 2011 with an article by Hans-Werner Sinn in the magazine "Wirtschaftswoche" (http://www.cesifo-group.de/de/ifoHome/policy/Staff-Comments-in-the-Media/Press-articles-by-staff/Archive/Eigene-Artikel-2011/medienecho_15173893_ifostimme-wiwo-21-02-11.html), followed by further publications. Sinn here presents the beginning of the debate (<http://www.hanswernersinn.de/de/kontroversen/DokumentationTarget>). Shortly thereafter, he underpins his statements scientifically in a working paper (http://www.cesifo-group.de/DocDL/cesifo1_wp3500.pdf). In his book "The Euro Trap" (<https://www.cesifo-group.de/de/ifoHome/publications/individual-publications/Euro-Trap.html>), Sinn describes his fundamental criticism of the European Monetary Union in detail. The author, at that time president of the Munich ifo Institute, emphasizes the emergence of massive target balances. From the outset, Sinn suspects that the balances will sooner or later lead to a loss primarily borne by the German taxpayer.
- The central banks participate with expert contributions describing the functioning of the target remittance system and largely abstain from political recommendations. Examples can be found here (<https://www.bundesbank.de/resource/blob/603530/165b3f7b78544eeb1c45b72e82dc46e0/mL/2011-gb-target2-saldo-data.pdf>), here (<https://www.bundesbank.de/resource/blob/603506/6b6203dab2bc5fe314394c024a157e1c/mL/2017-12-mb-target2-saldo-data.pdf>) or here (<https://www.ecb.europa.eu/paym/target/target2/html/index.en.html>). Benjamin Weigert (<https://www.bundesbank.de/de/bundesbank/organisation/zentralbereiche/dr--benjamin-weigert-715626>), former Secretary General of the German Council of Economic Experts (Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung) and now Division Head of "Financial Stability" of the Bundesbank, compares the target system with the settlement system of the Federal Reserve in the USA in an article (<https://link.springer.com/content/pdf/10.1007/s10273-012-1369-0.pdf>) together with Jens Klose.
- The historical development of the target balances has been described many times. The European Central Bank regularly publishes current data here (https://www.ecb.europa.eu/stats/policy_and_exchange_rates/target_balances/html/index.en.html).
- In the summer of 2018, Hans-Werner Sinn publishes a guest article entitled "Irreführende Verharmlosung" (<https://www.faz.net/aktuell/wirtschaft/eurokrise/bringen-die-target-salden-deutschland-in-gefahr-15723567.html>) (Misleading trivialization) in the "Frankfurter Allgemeine Sonntagszeitung" (FAS). Sinn argues that target balances should not be played down as other economists in Germany and the central banks would have done. He argues that in fact, these balances are an overdraft loan within the Eurosystem with substantial risks for the German taxpayer namely if a single central bank becomes insolvent or if a single country with high target debt leaves the euro zone.
- Martin Hellwig counters, also in the FAS: "Wider die deutsche Target-Hysterie" (<https://www.faz.net/aktuell/finanzen/finanzmarkt/unberechtigte-panik-vor-italien-austritt-fuer-eurowaehrung-15712671.html>) (Against the German target hysteria). He argues that the argumentation put forward by Sinn and other economists is flawed and spreads unnecessary hysteria. In his view, national central banks within the Eurosystem are to be regarded as branches of a single institution. Hellwig argues that their separate accounting is misleading here because it suggests the impression of

nationally distributed asset claims which, however, do not exist in this way. Only the ECB's capital key is decisive. Target balances are part of an open internal market which especially offers and has offered great advantages to countries such as Germany. Even the withdrawal of a country with high target deficits, such as Italy, would not pose a problem because the target debt would simply be transferred to the new central bank institution to be created and thus maintained in full.

- In August 2018, Krahn publishes a generally understandable description of the target problem (<https://safe-frankfurt.de/policy-center/policy-publications/policy-publ-detailsview/publicationname/ueberscheinriesen-was-target-salden-tatsaechlich-bedeutend-eine-finanzoekonomische-ueberpruefung.html>). The result: Target balances per se are not a problem for the welfare of a country as long as a withdrawal from the monetary union can be ruled out. Even then, a problem would only arise in the unlikely event that the new central bank would reject the assumption of claims in the sense of legal succession.
- In autumn 2018, Adalbert Winkler publishes an article in "Wirtschaftsdienst - Zeitschrift für Wirtschaftspolitik" (<https://archiv.wirtschaftsdienst.eu/jahr/2018/10/grosse-summe-grosses-problem-warum-die-debatte-um-die-target-salden-so-hitzig-ist/>). There, he argues that the debate in Germany is so heated because the various parties have very divergent ideas about the risks involved in the ECB's balance sheet. In particular, the value of the securities bought up is important. Also, he argues the possible threat scenarios, such as the withdrawal of a country from the euro, are not thought through with the necessary realism. In this case, it would then become apparent that the moral risks painted on the wall in the discussion would be much lower if they existed at all.
- In December 2018, Clemens Fuest and Hans-Werner Sinn publish another fundamental contribution (<http://www.hanswernersinn.de/dcs/20181220-cesifoforum-fuest-sinn-target-risks-without-euro-exits.pdf>) to the debate. There they show that under the assumption of an insolvent central bank ("financial collapse"), even without the withdrawing of a member state from the monetary union, a communitarization of debts between countries can be expected. They conclude that in the European monetary system, individual central banks could become insolvent and illiquid due to the prevailing legal rules and that in this case, they would not be in a position to pay interest properly on their target balances. However, the taxpayers of the other countries run the risk of a loss of purchasing power: they argue that the resulting risk sharing within the euro zone contradicts the European treaty and requires correction by limiting the target balances and ultimately a regular repayment.
- In January, Krahn responds (<https://safe-frankfurt.de/policy-center/policy-publications/policy-publ-detailsview/publicationname/target-balances-and-financial-crises.html>) by examining the prerequisites for a central bank insolvency in more detail in the Fuest/Sinn 2018 argument. He comes to the conclusion that, looking at the capital and supervisory standards introduced in the monetary union since 2012, the constellation assumed makes the insolvency of a single central bank very unlikely. So, in his view the description of the Fuest/Sinn situation is only valid in extreme scenarios namely in Armageddon scenarios, for which sensible policymaking is not to be expected anyway and forward-looking planning is therefore not necessary.
- February: A comprehensive presentation and critical commentary of the entire discussion can be found in Martin Hellwig's (<https://www.coll.mpg.de/martin-hellwig>) article in Perspektiven der Wirtschaftspolitik (<https://www.degruyter.com/view/j/pwp.2018.19.issue-4/pwp-2019-0002/pwp-2019-0002.xml>).

Would you like to take part in the discussion? Then send us your contribution to the debate at krahn@safe.uni-frankfurt.de

We look forward to the further debate!

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See also the other articles in the target debate:


- The Risk of Government Debt on a Central Bank's Balance Sheet Should not be Exaggerated (<https://safe-frankfurt.de/policy-blog/details/the-risk-of-government-debt-on-a-central-banks-balance-sheet-should-not-be-exaggerated.html>)
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