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## TARGET2 (IM)BALANCES — THE SNEAKY CATCHER IN THE RYE FOR THE EUROZONE?

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*Pour aller plus loin*

# 1. THE EZ AND THE CCAs/OCAs THEORY (1)

1. CCAs are present throughout monetary history, as required by international trade and trans-border exchange.
2. The gold standard—even its bimetallic version—was the most recognizable, most durable CCA.
3. President R. Nixon (1971) brought the gold standard to an end by abolishing the US\$ convertibility. From that moment on, every single currency has a mere fiscal anchor.
4. Robert Mundell (1961)—a M. Friedman's disciple—envisioned a monetarist-like framework that mimicked the gold standard onto trans-national monetary groupings in a fiat-money world. He proposed an original, Nobel-awarded theory of monetary equilibrium, the Optimal Currency Areas (OCAs).
5. Amazingly (BTW), the J.M. Keynes' Plan (*bancor*), that was discarded to inspire the post-Bretton Woods global monetary order, regained traction.

# 1. THE EZ AND THE CCAs/OCAs THEORY (2)

6. OCAs' baseline consists of spurring members to forgo their 'beggar-thy-neighbour' trade policies. The optimality conditions set up the rules to avoid other forms of free-riding inside the CCA.

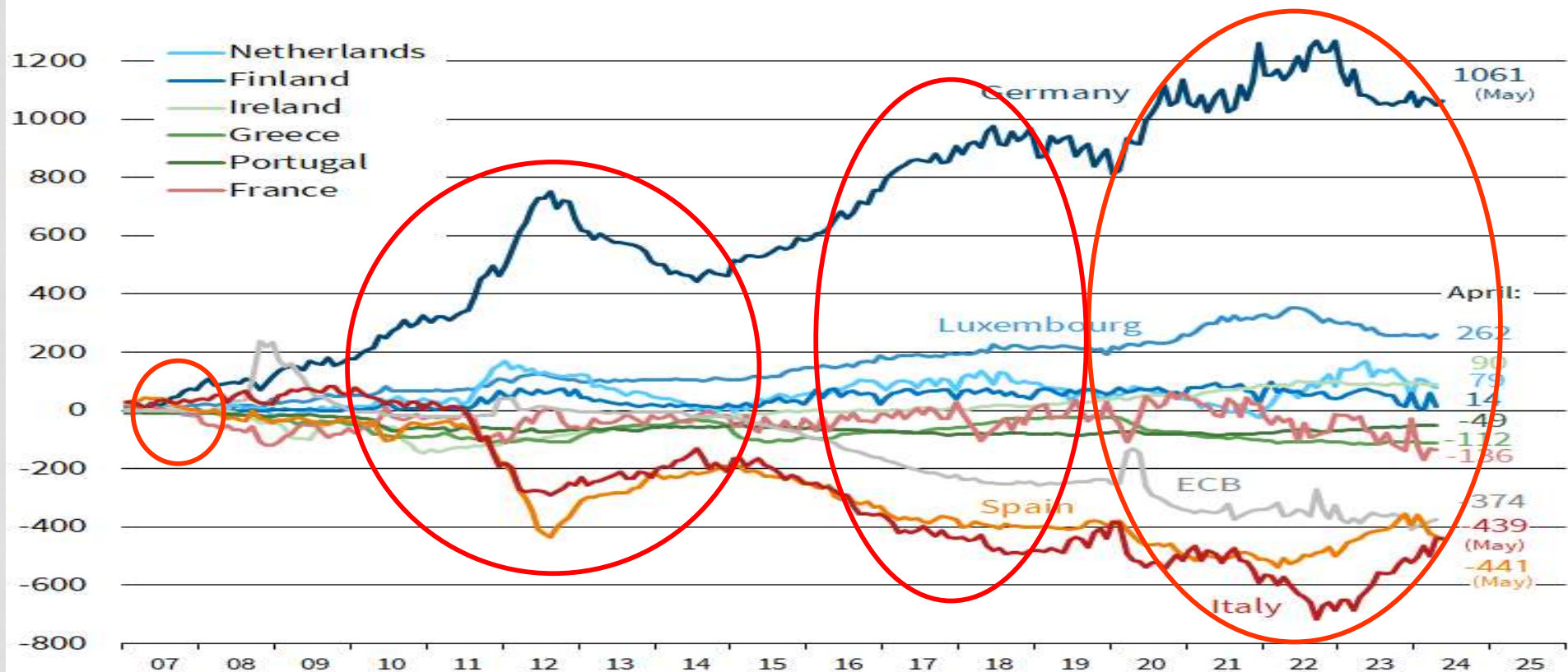
7. In further developments, OCA Theories summed up its premises by the OCAs' trilemma, that has been versioned in different ways, and for related purposes [Mundell-Fleming (1963-1962) and Rodrik (2006)].

8. The euro would be 'die beste der möglichen Welten' (G.W. Leibniz), there is no trilemma:

OCA	Monetary independence	Exchange-rate stability	Financial integration
Bretton Woods	✓	✓ / ✗	✓ / ✗
Pre-€	✓	✓ / ✗	✓ / ✗
Post-€	✓ 🤔	✓	✓

## 2. BEYOND A PAYMENT SYSTEM (NCBs' money to the rescue of States and banks in distress)

**Target Balances of Selected National Central Banks and the ECB, May 2024**  
In billion euros; end-of-month values



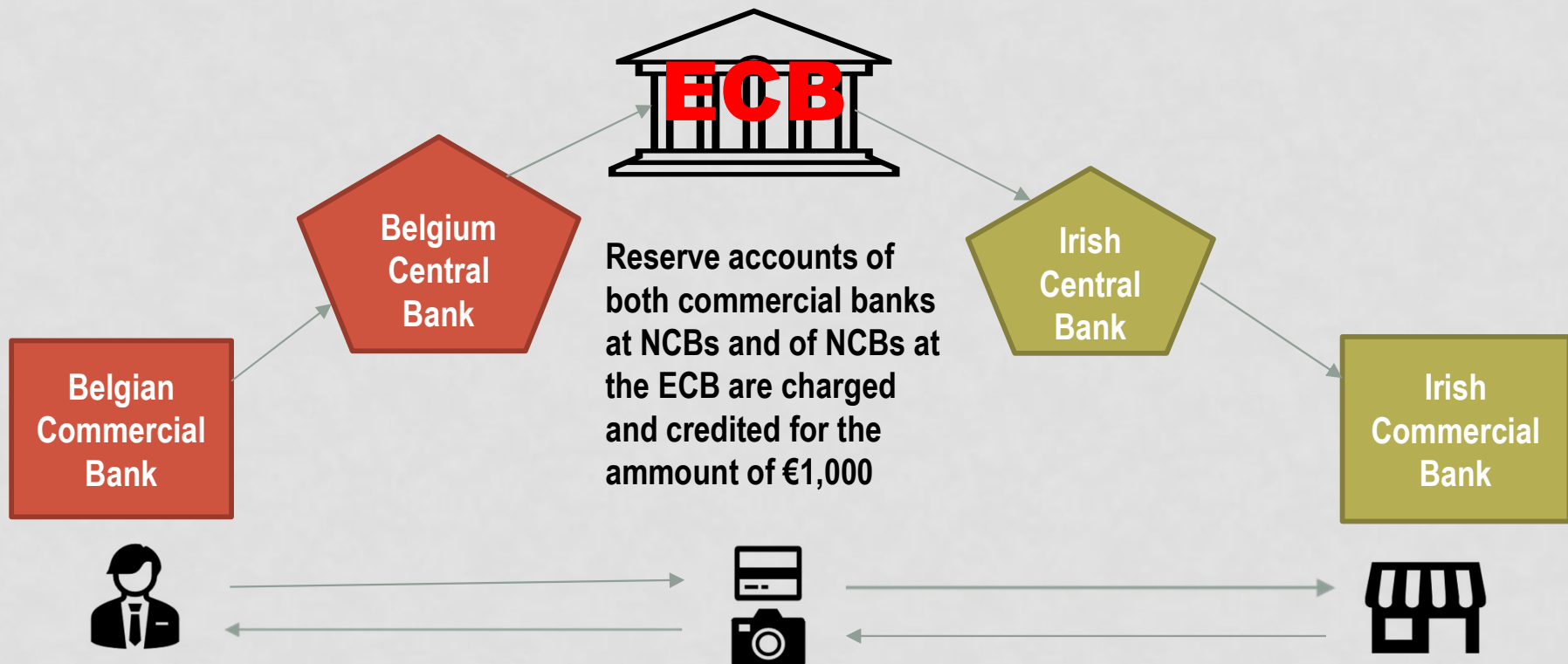
Source: Sinn/Wollmershäuser "updated" (2012) »Target Loans, Current Account Balances and Capital Flows: The ECB's Rescue Facility«, International Tax and Public Finance; European Central Bank; Deutsche Bundesbank; Banca d'Italia; Banco de España; Bank of Greece.

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### 3. How T2 (IM)BALANCES WORK (1) (The balance of payments strand)

1. In October 2007, the private interbanking market collapsed as confidence among banks faded. T2 remained in the EZ as the only reliable trans-border system of payments

2. The case of a professional Belgian photographer who purchases a camera from an Irish retailer:

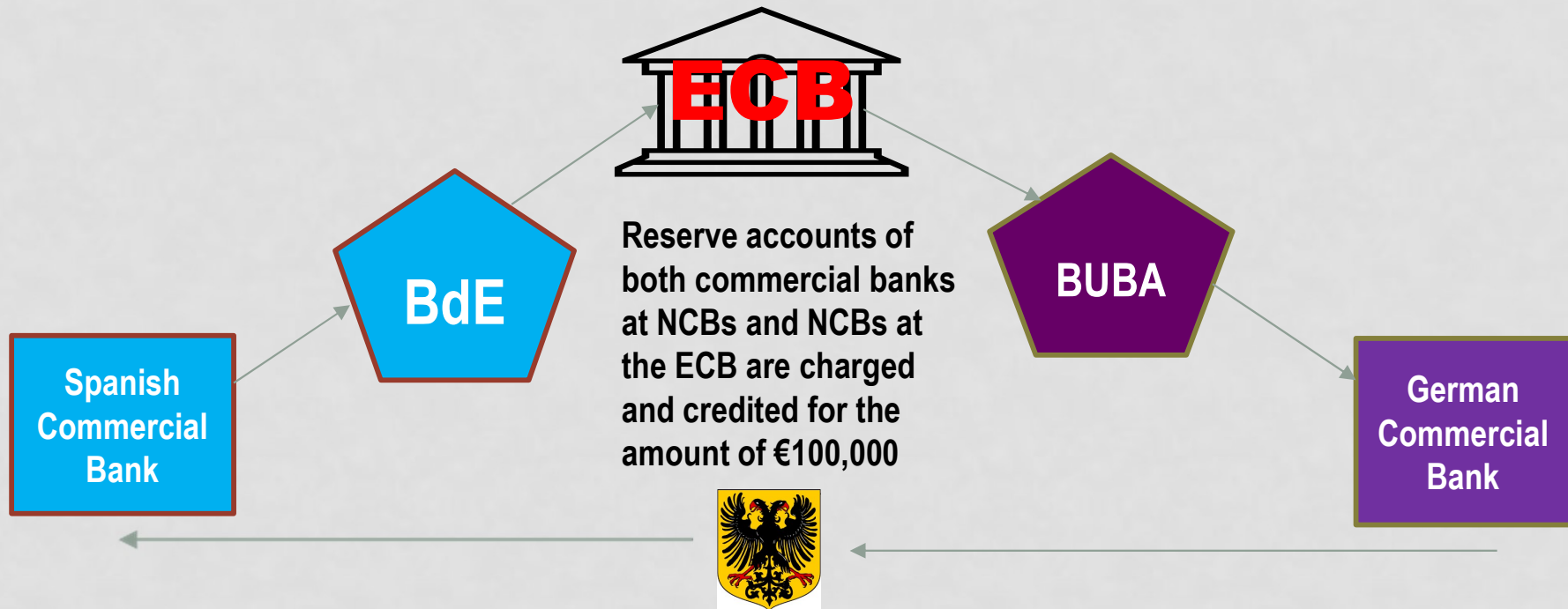


### 3. How T2 (IM)BALANCES WORK (2)

(The financial flows/current account strand: QE and money to safe havens)

3. Eurosystem QE: NCBs purchase securities (mainly EZ public debt) in the secondary market from national banking institutions.

4. As spread fluctuations get narrow, former security holders fly with their money to the central-north EZ, considered safer than the periphery, fostering the flow of capitals that way



### 3. How T2 (IM)BALANCES WORK (3) (Unlimited overdraft, non-redeemable 'credit')

5. T2 Guideline ECB/2012/27: the *novation* mechanism, a hierarchical structure of balance-sheets. T2 position of NCBs are netted at the end of each day, and credit and debit positions are transferred to the ECB "to give rise to an *intra-Eurosystem obligation* of the Eurosystem CB of the payer towards the Eurosystem CB of the payee".

6. This shenanigan makes no book-keeping sense at all, and it must be considered as the simple *collectivization* of credit positions: «your debt is yours, but my credit is ours».

7. Liquidity provision is automatic, and unlimited. Central bank money (Base Money = cash + bank reserves) is created through interbank reserves at any NCB's demand.

8. The Agreement on Net Financial Assets (ANFA), unknown until 2015, leaves the quality of collaterals at the discretion of NCBs for liquidity provision, and equalizes all AZ sovereign bonds for that purpose regardless market spreads.

9. *Seigniorage*: the one who issues the money (NCBs) is the first in the line, and does not suffer the depreciation he/she causes. T2 debts yield the same rate as the deposit facility (3.75%) [MRO 4.25%].



## 4. T2 DISTRIBUTIONAL EFFECTS: HYPOTHESES (1)

(Taxation without representation)

1. Liquidity is given (almost) for free and in ordinary, non-distress situations.
2. Bank money (MB) flows from the periphery to the core of the EZ:
  - a) Asset bubbles might be more intense in core countries.
  - b) Inflation trends might be more persistent and acute in core countries.
  - c) Peripheral countries get the *seigniorage* tax.
3. *Tiering* policy shows the concern of the Eurosystem about money surpluses in the core EZ countries.
4. In the case of the EZ's implosion or exit of a country (not envisaged in EU Law) both remaining and exiting countries, whether debtors or creditors would make a big loss.



## 4. T2 DISTRIBUTIONAL EFFECTS: HYPOTHESES (2)

(Some comparative data)

COUNTRY	CPI		UNEMPLOYMENT		GDP		T2	
	Dec 2022	Dec 2023	Dec 2022	Dec 2023	Dec 2022	Dec 2023	Dec 2022	Dec 2023
Italy	8.18%	5.72%	8.1%	7.6%	€1,96bn	€2,21bn	-€0,72bn	-€0,68bn
Spain	5.71%	3.10%	12.9%	11.8%	€1,34bn	€1,46bn	-€0,49bn	-€0,39bn
Germany	8.12%	3.71%	5.7%	5.3%	€4,08bn	€4,12bn	+€1,31bn	+€1,12bn

1. The 'Marvin King effect' [persistent inflation in the center/north, persistent unemployment in the periphery] is not [yet] evident on the inflation side.
2. In 2023, T2 German credit position represents 30% of the joint GDP of Italy and Spain.
3. Incentives for convergence in the EZ or a catcher in the rye for all seasons (not just for shocks)? Are T2 the backstop for the EZ's '*Hotel California clause*'?
4. Every NCB issues its own money, endorsed by asymmetrical quality assets (public and private loans).

# *POUR ALLER PLUS LOIN*

- ❑ A. RUIZ-OJEDA, “We’ve got a serious pan-EU constitutional problem –not just a German one–”, *Epicenter*, 19 abril 2021.
- ❑ H.W. SINN, *The economics of Target Balances. From Lehman to Corona*, Palgrave-Macmillan, Cham 2020.
- ❑ S. MURAU y M. GIORDANO, “European Monetary Unification through Novation: The Political Economy of the TARGET System”, 26th Conference Forum for Macroeconomics and Macroeconomic Policies (FMM), Berlin, 20-22 octubre 2022.