

Newsletter



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The Bundesbank Executive Sarrazin – Implications for the German and European Central Bank

Markus Heckel

University of Duisburg-Essen, Department of Economics
Former Visiting Research Fellow, IIMA

1. Introduction

The German Bundesbank has long been admired for its integrity, independence, and inflation performance. Since August 2010 a Executive Board member of the Bundesbank attracted national and international attention due to statements about Jews and Muslim immigrants. This Newsletter argues that the affair of board member Thilo Sarrazin has three implications: First, it has damaged the national and international reputation of the Bundesbank. Second, the appointment process of the Bundesbank board members must be reformed. And, third, the prospects of a future German European Central Bank (ECB) president have declined.

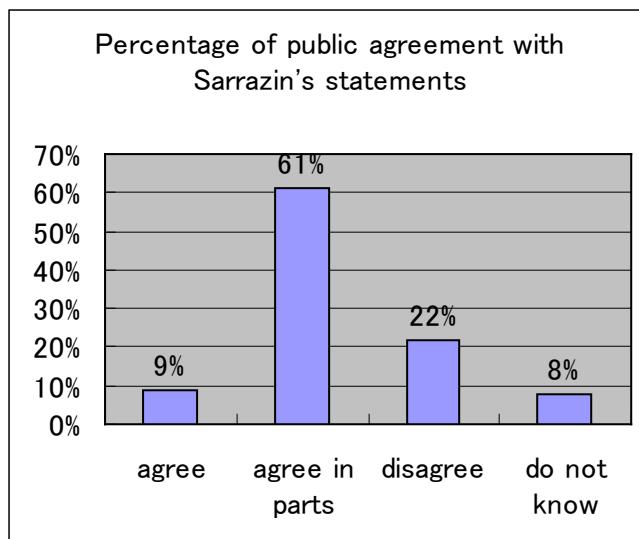
2. Sarrazin

Dr Thilo Sarrazin, born on Feb. 12, 1945, joined the German Bundesbank as Executive Board member in May 2009 after serving seven years as Finance Minister of the state Berlin. During his impressive career, Sarrazin has been the focus of several controversial debates. Since August 2010, the debate escalated due to his statements about Jews (“Jews share a particular gene”) and Muslim immigrants.

On Aug. 30, 2010, Sarrazin published the best-selling book “Deutschland schafft sich ab” (“Germany Abolishes Itself”) in which he accuses Germany's Muslim population of refusing to integrate and relying heavily on social welfare programs. Furthermore, Sarrazin argues that uneducated immigrants are a burden for German society and that Muslim population due to a high fertility rate may undermine Germany's population within a few generations.

Sarrazin's polarizing comments have drawn criticism from all sides of the political spectrum, despite a relatively high degree of public support. A Forsa Institute opinion poll on Sep. 2 found out that 61 percent of the population agree in parts and 9 percent agree fully with Sarrazin's theses. Only approximately one fifth disagrees (see Table 1).

Table 1: Public agreement with Sarrazin's statements



Source: Opinion poll by the Forsa Institute.

3. The procedure of the resignation of a Bundesbank Executive Board member

Chancellor Angela Merkel and President Christian Wulff put intense pressure on Bundesbank president Dr Axel Weber, who leads the Bundesbank since 2004, to release Sarrazin from his position. The chancellor called Sarrazin's statements about Jews and Muslim immigrants “completely unacceptable” and urged the Bundesbank to take decisive action. The Bundesbank released on Aug. 30 a strongly worded statement condemning Sarrazin's comments, arguing they violated the bank's code of conduct¹ and damaged the central bank's reputation and credibility.

The Executive Board decided on Sep. 2 unanimously to submit a formal request to

¹ See, webpage of the Bundesbank, www.bundesbank.de

President Wulff for Sarrazin's dismissal. In a further step, the Board dispensed Sarrazin from all his responsibilities. However, the Bundesbank's request to terminate a Executive Board member's contract could prove to be difficult. It is uncertain if a dismissal complies with legal terms. In addition, there was a clear lack of public support for a removal. A second opinion poll by the Forsa Institute revealed that every second German citizen supported Sarrazin and only 34 percent were in favour of his dismissal. However, Merkel welcomed the decision of the Bundesbank, saying she acknowledged the move with "great respect".

One week later, Sarrazin unexpectedly anticipated his removal and agreed to resign from his position by the end of September. Concerning this, the Bundesbank released following press statement:

The Executive Board of the Deutsche Bundesbank and board member Dr Thilo Sarrazin are mindful of their responsibility regarding the institution of the Deutsche Bundesbank. In view of the current public discussion, the parties concerned will terminate their working relationship by mutual consent at the end of the month. The Bundesbank's Executive Board has withdrawn its application of 3 September 2010 for the dismissal of Dr Thilo Sarrazin and retracts the value judgments it made in its press release of 30 August 2010. [...]

[Extract of the] Press release of the Executive Board of the Deutsche Bundesbank, Frankfurt am Main, Sep. 9, 2010.

The Bundesbank's decision to withdraw from its critique of Sarrazin's discriminatory comments and even thank him for the "work he has accomplished" drew heavy criticism to the central bank. Considering the speed of the process, it is doubtful that the Bank acted independently in its decisions. Rather, the *Frankfurter Allgemeine Zeitung* (Sep. 15, 2010) reports that the resignation of Sarrazin was heavily influenced by President Wulff, i.e. political interference undermined the Bank's independence that is the fundamental principle of its operations.

4. Quo vadis glorious past? Undermining the reputation and credibility of the Bundesbank

Not all Germans believe in God, but they all believe in the Bundesbank
(Jacques Delors, President of European Commission, 1992)

David Marsh (*Financial Times*, Sep. 1, 2010) argues that before the introduction of the *Euro* the Bundesbank was the “most powerful central bank in Europe”. With the foundation of the European Central Bank in 1998, the Bundesbank has seen its influence eroded after losing all elevated responsibilities for monetary policy. However, as the ECB’s role model the Bundesbank was still being highly respected. The recent events have changed the situation fundamentally. The Bundesbank became a “laughing stock” and unflattering phrases such as “disgrace” and “embarrassment” are making their way through the national and international press.

The damage of the central bank’s reputation raises two questions: First, how could a person like Sarrazin be appointed to the Executive Board? Second, does the Bundesbank really act independent? Instead, the politicians’ and the Bundesbank’s behaviour raise the assumption that policymakers have much more control over the Bank than it is commonly known.

There is no doubt that a board member making such public statements is damaging to an institution’s reputation. Sarrazin discredited the name of the Bundesbank in the course of spreading his controversial theses that has nothing to do with it. Had Sarrazin not been a central bank official – not many people would have paid attention to him and his book. However, Sarrazin’s resignation does not save the Bundesbank’s reputation. A finance expert of the Green Party, Gerhart Schick, said that “the Bundesbank was damaged to a high degree and that cannot be fully revoked through a resignation.”²

The Bundesbank published a statement arguing that Sarrazin’s remarks damaged the bank’s reputation and violated the Governing Council’s ‘code of conduct’. According to this code, board members must at all times act in a way “that upholds and promotes the Bundesbank’s reputation and the public’s trust in the Bundesbank.”³ Ten days later, the central bank withdrew its statements against Sarrazin. This behaviour can also be interpreted as working in opposition to its own rules, because it demonstrates that the Bank was not able to act independently from politicians. The *Frankfurter Allgemeine Zeitung* (Sep. 11, 2010) described the Bundesbank as a “puppet of the media and politicians”.

It is obvious that the Bank is confronted with a complicated balancing act between defending its reputation and protecting its independence from politicians. However, it appears that the Bundesbank incurs severe damage from the Sarrazin affair. With the statement that it will not comment on the topic of Sarrazin any longer, the Bundesbank

² *Spiegel online*, Sep. 10, 2010, <http://www.spiegel.de/politik/deutschland/0,1518,716831,00.html>

³ Statement by the Deutsche Bundesbank, Aug. 30, 2010.

hopes that the scandal will be forgotten quickly. Instead, a reform of the central bank law regarding the Executive Board is needed.

4.1 The Bundesbank as a pool for deserved politicians? – Reform of the Bundesbank

The problem of dismissing Executive Board members has a basis in the Bundesbank Act. The process of how and from whom a Executive Board member can be removed is missing. The law only regulates the appointment of the Bundesbank's six board members by stating that the members of the Executive Board are appointed by the president of the Federal Republic (§ 7-3). As a consequence, it is argued that only he (currently Wulff) can dismiss board members from office, on basis of a formal request by the Board. In practice, this has never happened before.

Sarrazin was long-known for his polemic statements. How was his appointment to the Bundesbank's board possible? In particular, given that the head of the Bundesbank Weber had unsuccessfully tried to prevent Sarrazin's appointment in 2009. The center-left Social Democrats (SPD)-led federal states of Berlin and Brandenburg pushed through their candidate, the SPD-member Sarrazin. Gerd Langguth⁴ reports that even Chancellor Merkel was not happy about Sarrazin's nomination but wanted to avoid disputes within the grand coalition.

A key problem is that politicians of the federal states are allowed to nominate Executive Board members and that the Bundesbank Law does not require specific knowledge of monetary policy or economics as a prerequisite. As a consequence, instead of choosing the best suited finance experts, the federal states tend to nominate loyal politicians, or politicians they want to "get rid of". That could be the case with Sarrazin. There is rumour that the Head of the state Berlin, Klaus Wowereit, wanted to dispose Sarrazin and, hence, praising his abilities nominated him for the Bundesbank's board.

It is hard to imagine that the former prestigious Bundesbank is a parking space for deserved or incompetent politicians. This detrimental practice reveals that the current law does not protect the independence of the Bundesbank. Hence, a reform of the "bizarre legal stipulation"⁵ of the Bundesbank's appointment process is needed. The reform of Bundesbank Act should consist of four principles:

⁴ *Spiegel online*, Sep. 7, 2010, <http://www.spiegel.de/politik/deutschland/0,1518,715773,00.html>

⁵ David Marsh, *Financial Times*, Sep. 1, 2010.

1. the law should secure the central bank's independence and weaken the role of the federal states in the appointment process
2. the appointment process of Executive Board members must be made transparent
3. the law must regulate the dismissal process of Executive Board members
4. the professional quality of Executive Board members must be enhanced

Public bidding like the Bank of England has practised since 2008 is a promising method to secure the appointment of competent finance and monetary experts. Here, the Bundesbank should be provided with the right to comment and if necessary to refuse candidates it does not view as qualified. The way how to secure central bank independence, regarding the dismissal of Executive Board members, is demonstrated in the Statute of the European System of Central Banks (ESCB) which claims that only the Court of Justice can dismiss a member of the Executive Board on application by the Governing Council or the Executive Board (Article 11-4).

Gerlach and Yoo⁶ stress the importance of professional quality of Executive Board members and argue that quality requirements for European Central Bank (ECB) Directory members are higher than in the Bundesbank. This leads to the problem that Bundesbank Executive Board members could be rejected for ECB top posts – an embarrassing scenario given the fact that the Bundesbank is often referred to as role model for the ECB.

5. In search of the next president of the European Central Bank

Sarrazin's statements reached the Frankfurt-based European Central Bank and its current president, Jean-Claude Trichet, has been “appalled” by the remarks. However, Trichet's eight-year term as president will expire in October next year. The formal process of finding a successor is expected to start not before the beginning of next year. However, intense negotiations have already begun and two promising candidates are circulating in the press: Bundesbank president Axel Weber and Mario Draghi, Governor of the Bank of Italy.

Two unwritten conventions have evolved regarding the ECB's top posts: First, European Union policy seeks a balance between small and big countries. Second, a geographically balanced allocation of northern and southern countries is viewed as desirable. According to these tacit agreements, a German head of the ECB would be

⁶ Gerlach and Yoo: Zur Stärkung der Deutschen Bundesbank, March 22, 2010, www.oekonomenstimme.org

more likely than an Italian one, because southern countries are already represented by a Portuguese Vice President since June 2010 (Table 2).

Table 2: The presidents and vice presidents of the ECB
since its establishment 1 June 1998

ECB president	Country	Term	Vice president	Country	Term
1. Duisenberg	Netherlands	1998-2003	1. Noyer	France	1998-2002
2. Trichet	France	2003-2011	2. Papademos	Greece	2002-2010
			3. Constâncio	Portugal	2010-
<i>3. Draghi*</i>	<i>Italy</i>	<i>2011</i>			
<i>3. Weber*</i>	<i>Germany</i>	<i>2011</i>			

* Note: the names in italics are potential successors

Weber was widely viewed as front-runner to replace Trichet as ECB president next year. Although David Marsh (*Financial Times*, Aug. 2, 2010) fears that a German ECB president would “inflame north-south divisions in Europe”, it has widely been argued that Germany’s government is campaigning the Bundesbank president to the helm of the ECB and that Chancellor Merkel has the power to put him through. Hence, some observers believed that the issue seemed to have already been settled in favour of Weber.

Weber’s merits are the following: First, he enjoys high reputation as a monetary economist in Europe and the US. Second, he is seen as someone who can sharpen the ECB’s image as a conservative guardian of the *Euro* by protecting the ECB’s independence and reputation. As an inflation-fighting “hawk”, Weber focuses on price stability and may pressure weak euro zone countries to fix their finance problems.

However, the dispute over Sarrazin with its political implications called Weber’s leadership qualities into question and has dampened his position. In the first attempt to remove Sarrazin he failed to gain majority in the Executive Board. Weber’s critics are joyously pointing out his long list of errors, e.g. already in October 2009 he was unsuccessful in throwing out Sarrazin.

That was not his only misstep. Weber’s critique of the ECB’s decision on May 10, 2010 to purchase the government debt of financially weak euro zone countries, such as Greece and Ireland has triggered persistent tension with other Governing Council members. In contrast, in August 2010, he did rather “dovish” comments by arguing that the ECB should continue its stimulus measures through the end of 2010. A statement that compromised the ECB, especially President Trichet, since no decision had been announced at that time. Weber’s undiplomatic outspokenness does not fit to the

consensus-based culture of the ECB.

The other candidate, Draghi from the Bank of Italy, keeps a lower profile, although highly respected as former economics professor and as chair of the Financial Stability Board. However, his chances are rather small: First, the geographical criteria requires a candidate from a northern euro zone country. And, second, Draghi's former position as a top official at Goldman Sachs International from 2002 to 2006 is not admired by everyone, especially recently due to the US investment bank's involvement in the Greece financial crisis.

The difficulties of both candidates may open the door for additional candidates from a smaller northern European country. There is still enough time, before the governments of the Member States will decide on the next ECB president.

6. Conclusion

This Newsletter has argued that the affair of Executive Board member Sarrazin has damaged the Bundesbank national and international reputation, that the appointment process of the central bank's Board members must be reformed, and that Bundesbank president's Weber prospects of a promotion to the helm of the ECB have been dampened.

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Address: 3-2, Nihombashi Hongokucho 1-Chome, Chuo-ku, Tokyo 103-0021, Japan
Telephone: 81-3-3245-6934, Facsimile: 81-3-3231-5422

〒103-0021 東京都中央区日本橋本石町 1-3-2
電話 : 03-3245-6934 (代) ファックス : 03-3231-5422
e-mail: admin@iima.or.jp URL: <http://www.iima.or.jp>