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**The Bail-in Procedure from an Ordoliberal  
Perspective**

Too Big for Bail-in?  
The First Stress Test for the European Banking Union

Berlin, 9 January 2017



# Table of Contents

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1. Ordoliberalism
2. The Constitution of Economic Order (Eucken)
3. The Context of Monetary Policy (Hayek)
4. Bail-in Procedure from an Ordoliberal Perspective
5. Implications

Eucken, Walter 1952: *Grundzüge der Wirtschaftspolitik*, Tübingen, Mohr-Siebeck.

Hayek, Friedrich August 1931: *Prices and Production*, New York, August M. Kelly Publishers.

Hoffmann, Andreas / Schnabl, Gunther 2016: The Adverse Effects of Unconventional Monetary Policy. *Cato Journal* 36, 3, 1-36.



# 1. Ordoliberalism (Hero Moeller)

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## **The Roots**

- The thinking is based on Adam Smith and other classical liberal economists. It is strongly influenced by the negative experience of state interventionism in the first half of the 20<sup>th</sup> century (Germany/Soviet Union).
- Hyperinflation (1921-1924) destroyed the German middle class.
- The rise of the German dictatorship was facilitated by the concentration of economic power.

## **The State as Guardian of Economic Order**

- The state creates a framework which puts limits on the economic power of individuals, companies and associations.
- Economic freedom ensures growth, welfare and therefore political stability.



# The Constitution of Economic Order (Eucken 1952)

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## Constitutive Principles

1. Free price determination,
2. stable currency (efficient allocation of resources),
3. open markets (competition),
4. private ownership,
5. liability of firms and households,
6. freedom of contract,
7. stability of economic policy.
8. **All principles become only effective, if they are simultaneously fulfilled.**

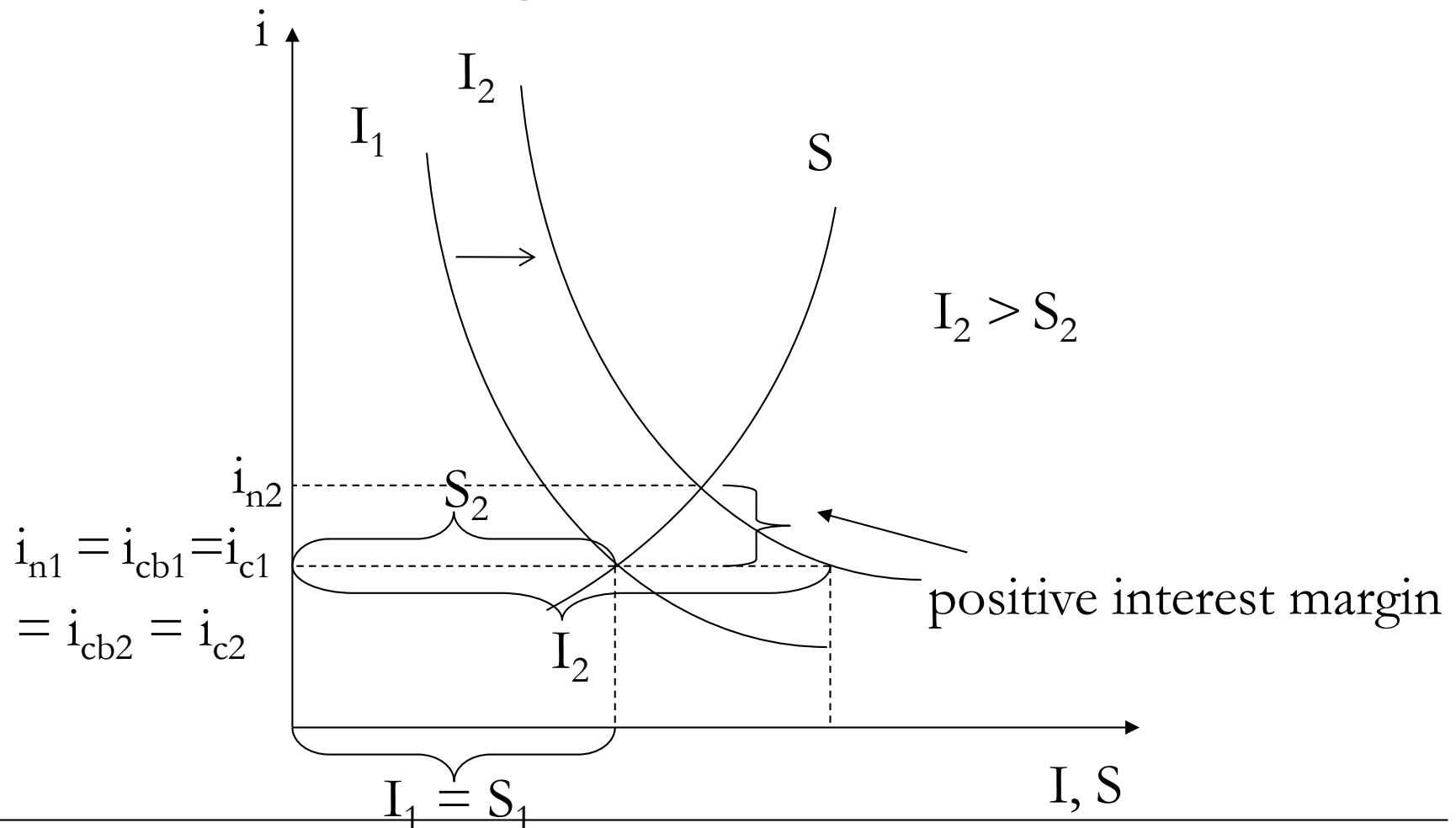
## Regulative Principles

1. Competition authority combats monopolies and cartels.
2. Redistribution policy via progressive tax (*Soziale Marktwirtschaft*).
3. Internalization of negative external effects.
4. Cope with anomalies in supply, e.g. in labor markets.

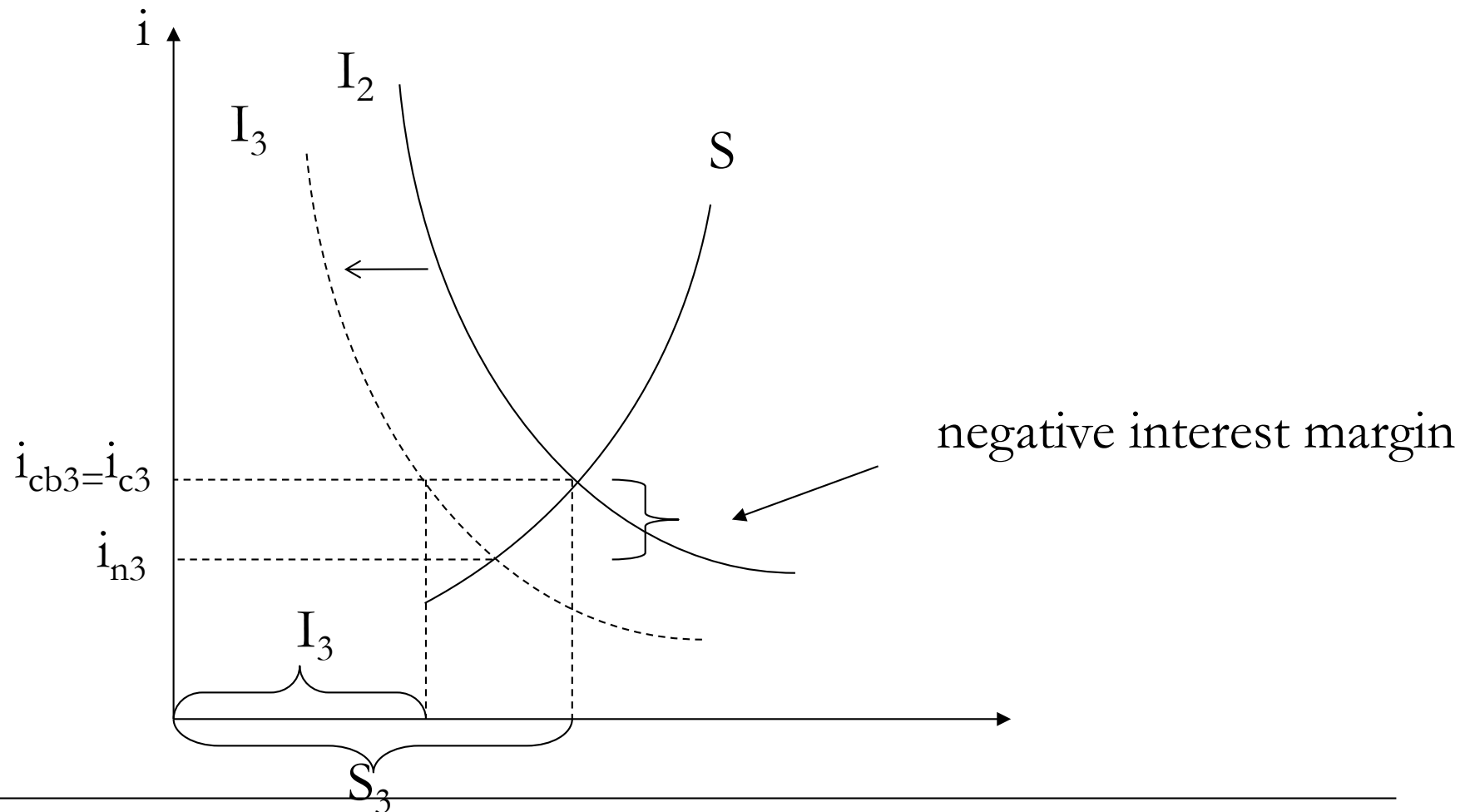


### 3. The Context of Monetary Policy (Hayek 1931)

#### Upswing: Type 1 Policy Mistake

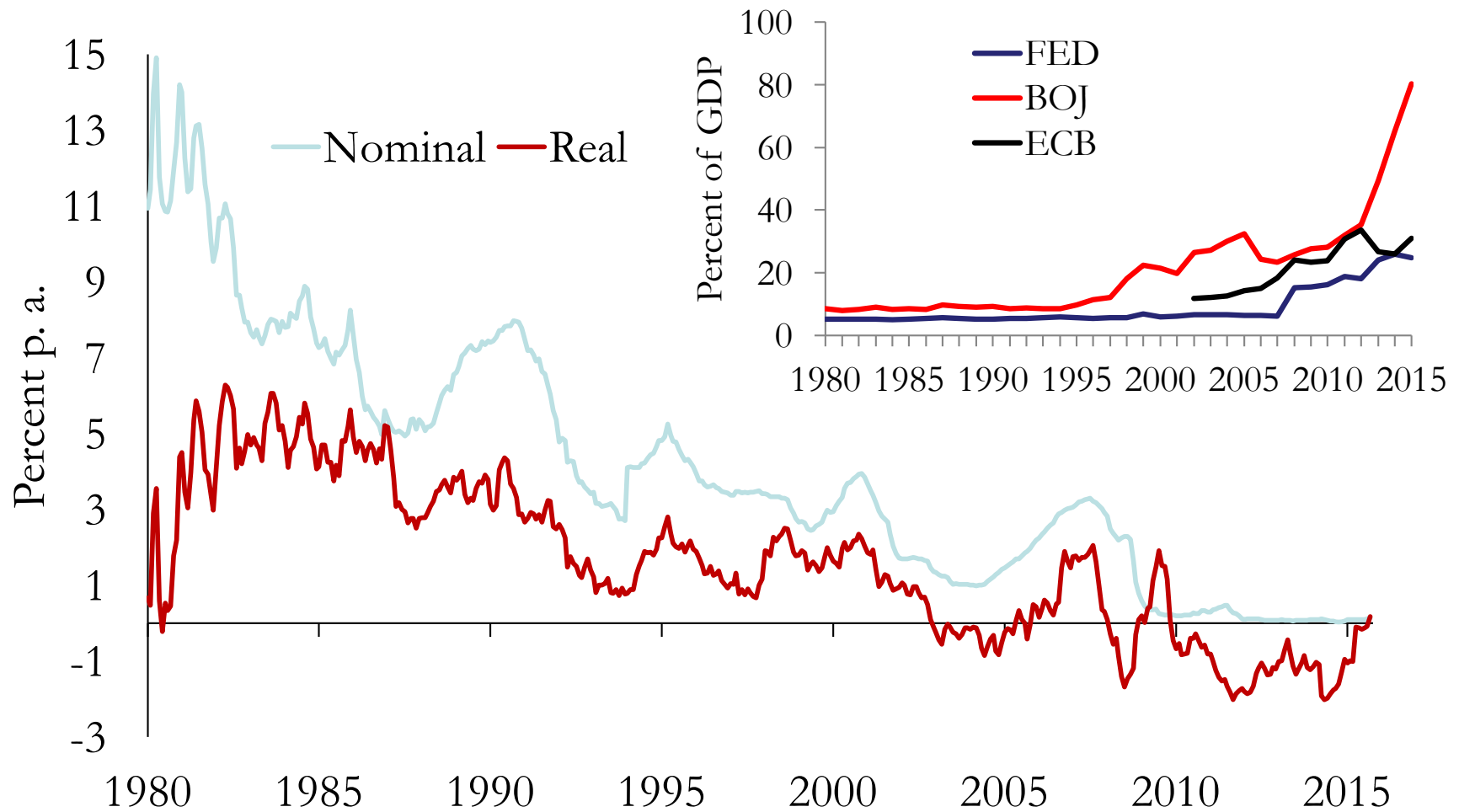


# Downswing: Type 2 Policy Mistake



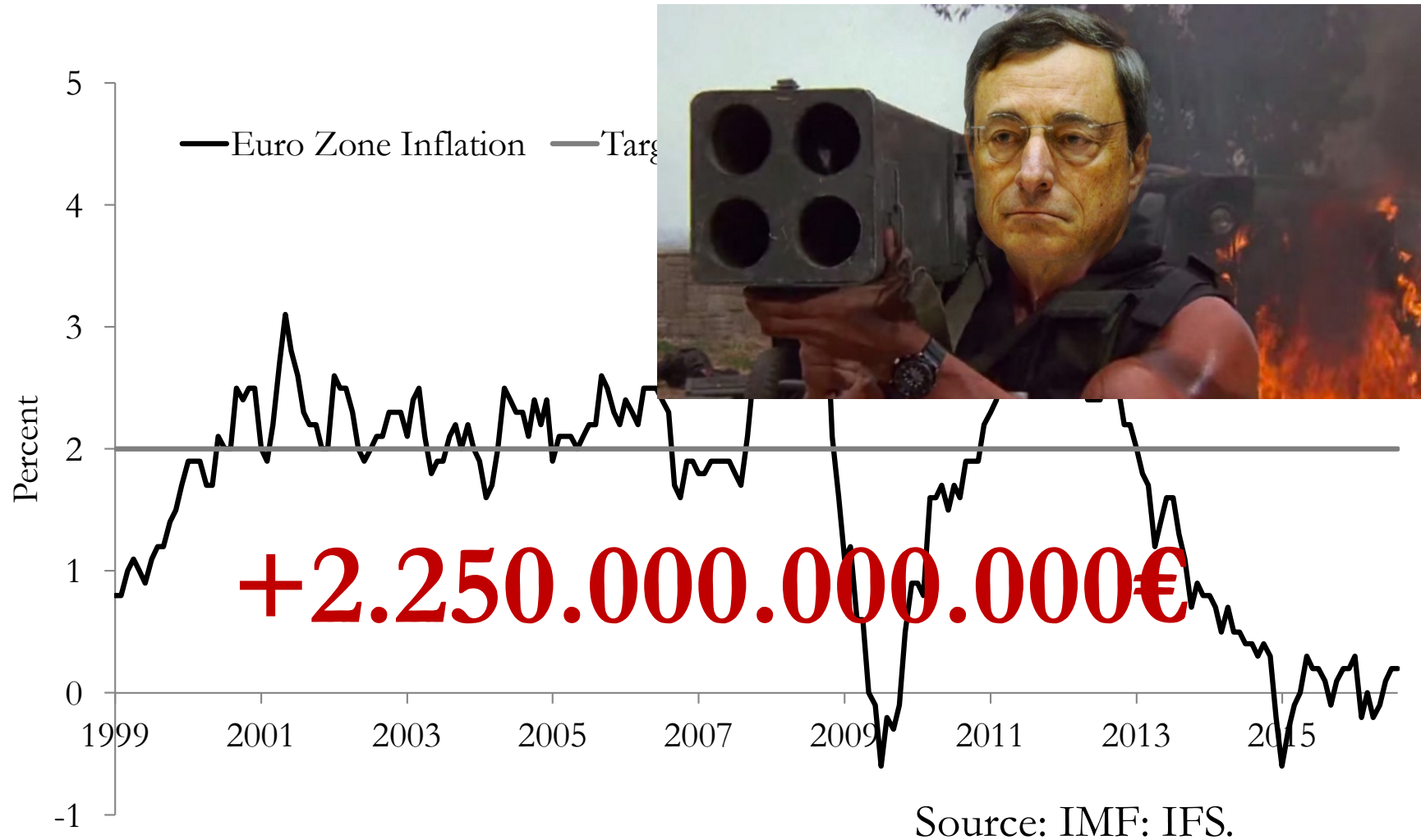


# Asymmetric Monetary Policy Crisis Management



Source: IMF: IFS.

# The Threat to Euckens Order







## 4. Bail-in Procedure from an Ordoliberal Perspective

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### The Financial Destruction of the Constitutive Principles

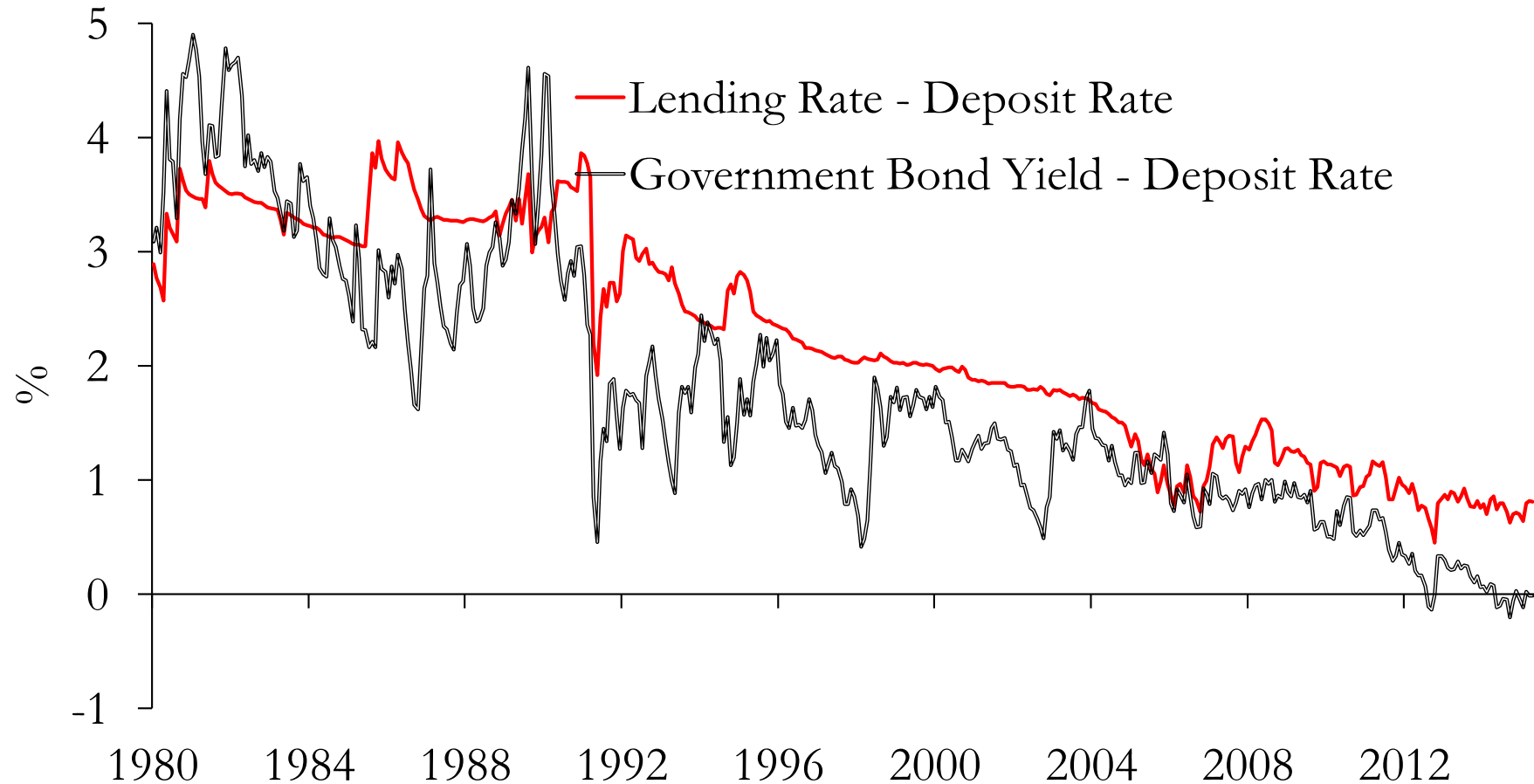
1. Unconventional monetary policy distorts prices on capital markets,
2. undermines currency stability and creates structural distortions,
3. promotes concentration in the financial and enterprise sector,
4. pushes forward hidden nationalization of banks and enterprises,
5. topples the liability principle.
6. Financial (and other) regulations interfere with freedom of contract.
7. The scale of monetary policy shocks is increasing.
8. The negative side effects of these policy measures show up in growing government debt, declining (productivity) growth, stagnating wages and growing income inequality.

### The Bail-in Procedure

1. Aims to resurrect the liability principle in financial markets,
  2. but fails to address all other deficiencies.
  3. While unconventional monetary destabilizes banks, the bail-in principle shifts the costs of monetary policy crisis management to the banks' capital owners and customers.
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# Interest Rate Spreads (Japan)



Source: IMF: IFS.



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**Thank you very much for your attention!**